BULLETIN

South African Nationals Living and Working Abroad

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This aid provides general information which may be useful to financial advisers who advise South African nationals, given the Tax changes which come into force in March 2020. It considers a number of related topics including residency, tax and several options available in respect of these. The content of the bulletin is referenced to specific sources which have authoritative standing and as such is based on factual publicly available information.

System and Basis for Taxation

South Africa has a residence-based tax system, which means residents, subject to certain exclusions, are taxed on their worldwide income, irrespective of where their income was earned. By contrast, non-residents are taxed only on their income from a South African source.

Under South African law a resident is defined by the Income Tax Act[1], as either an individual who meets the 'Physical Presence test or an individual who is Ordinarily Resident in South Africa under South African common law. The article published by South African Revenue Services (SARS)[2], 'When are you a tax resident' offers a detail insight to the above. The below provides an overview of the topic.

A Question of Residency

South Africa has taxing rights on any individual who is defined as resident under the Income Tax Act unless they are deemed to be exclusively a resident of another country for purposes of a double tax agreement.

The definition of 'Resident' as it pertains to individuals contains two principal tests. These are the tests of 'Ordinary Residence' and 'Physical Presence'. An individual must ensure that neither of these tests apply in order to fall outside the definition of 'Resident' in Section 1 of the Income Tax Act.

These concepts are considered below.

Physical Presence Test Overview

For South African nationals this test is straight forward, given its mathematical basis of counting actual days spent in South Africa. If all three conditions are met, then one is Resident for tax in South Africa as determined by their Physical Presence in South Africa.

- 91 days in current year AND
- 91 days in each of 5 years (including current year); AND
- 915 days in total over 5 years (including current year)

1 South African Income Tax Act 58 of 1962
2 SARS Tax Guide, http://www.sataxguide.co.za/when-are-you-a-tax-resident/?print=pdf

Ordinary Resident Test Overview

Unlike physical presence, which is defined in the Income Tax Act,Ordinary Residence is based on a doctrine that has been adopted by the Courts of South Africa and forms part of the countries Common Law. In essence, the doctrine defines one as Ordinarily Resident if they consider South Africa their home or intend to return to South Africa, irrespective of the time spent abroad.

Therefore, the test is based on matters of 'fact' relating to each individual and not on a set of rules. The facts that need to be considered are found in a number of specific court cases which have been collated into a very useful document produced by SARS and sites their Interpretation Note 3 (issue 2)[3].

Double Tax Treaties

Many South African nationals sit in a territory that has a Double Tax Treaty (DTA) with South Africa so understanding how such treaties impact on tax is important.

DTA's are bilateral inter-governmental agreements which are primarily designed to mitigate a) double taxation and b) double non-taxation and forms part of international law which is superior to the domestic law[4] of the contracting states.

The importance of a DTA is that it sets out specifics in respect of defining 'Residency' for the purposes of the treaty. Defining 'Residency' under the treaty is critical and it informs both states as to which state has the primary taxing rights and how to apply tax and the level of tax.

This means that the treaty definition or outcome of Residency may differ, under the treaty, from residency under a state's domestic law.

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South Africa DTA Example – United Arab Emirates

Given the number of South African expatriates living and working in the UAE we look at the South African UAE DTA which came into force on the 23rd November 2016[5] as it would be under this agreement that residency would be determined.

The purpose of the DTA has been set out as follows, 'Agreement between the government of the republic of South Africa and the government of the United Arab Emirates for ***the avoidance of double taxation*** and ***the prevention of fiscal evasion*** with respect to taxes ***on income'***[6]

Article 4 of the DTA sets out the method in which residency is to be determined. In particular, Article 4 clause 1 (a) defines any person who would be 'resident' under the Laws of South Africa as resident for the purposes of the treaty – the Laws of South Africa being all law in South Africa including the Income Tax Act and the Common Law doctrine which defines Ordinarily Resident. Therefore, if a SA Expatriate is either resident by way of ordinarily residence or physical presence then they are South African Resident for the purposes of the DTA and under such an outcome taxing rights fall to SARS.

However, there are instances where an individual may be resident of both contracting states and if such a conflict exists Article 4 clause 2 (a) to (d) need to be considered. Under these sub-clauses several tests are applied to the individual's circumstances in order to ascertain residency per the treaty.

These include identifying in which territory the individual has a home they are able to use, but don't necessarily live in, in the absence of a home where is it that they return frequently too and their centre of vital interest such as family.

[3] SARS Interpretation Note 3 (Issue 2) DATE: 20 June 2018 Act : Income Tax Act 58 Of 1962 Section : Section 1(1) Subject : Resident: Definition In Relation To A Natural Person – Ordinarily Resident

[4] The Constitution of the Republic of South Africa, 1996, clause 231 -233

[5] South Africa United Arab Emirates Double Tax Treaty, No 618, 23th November 2016

[6] ibid

The most pertinent sub-clause is (c) which in essence says that if residency could not be determined after considering points (a) and (b) that the 'nationality' of the individual will be used to determine residency under the DTA. As most South Africans cannot get nationalised as an Emirati, they will be South African resident under the treaty and South Africa will have the primary taxing rights.

Repeal of Foreign Employment Income Exemption and Future Taxation

South Africans working abroad in low or zero tax jurisdictions have enjoyed the exemption from South African tax to date. However, this position will change given the South African Government's announcement that section 10(1)(o)(ii) of the Income Tax Act will be repealed from 1st March 2020.

The implication is South Africans who meet the definition of 'Resident' for the purposes of taxation, will now become liable to tax on their foreign employment income.

However, after consultation which took place in September 2017 a range of supportive measures were put forward by the South African Treasury and SARS in their report (DRD17)[7] to the Standing Committee on Finance in Parliament. These measures need to be considered by all South African expatriates and provides a useful package of measures to minimise the impact of this change to the tax law and some of these are covered below.

I. Earned Income Exemption

An annual exemption will be put in place to exempt the first 1 Million Rand of earnings provided the individual is outside South Africa for a minimum 183 days during any 12-month period AND 60 of these days being consecutive.

For tax calculation purposes the rate of income tax applied subject to the above exemption, will be at the published personal income tax rate by SARS[8].

THE IMPLICATION IS SOUTH AFRICANS WHO MEET THE DEFINITION OF 'RESIDENT' FOR THE PURPOSES OF TAXATION, WILL NOW BECOME LIABLE TO TAX ON THEIR FOREIGN EMPLOYMENT INCOME

II. Retirement Provision

DRD17[9] makes specific reference to the fact that South Africans who return to South Africa and receive a foreign pension, in respect of services rendered abroad, will be exempt from taxation on that pension income. This is confirmed by SARS in the binding ruling on income tax Note 25 (issue 2) published in March 2017[10].

What this highlights is the importance for South African expatriates, particularly in low to zero tax jurisdictions, to consider the importance of bone fide pension provisions and this is dealt with in more detail under the next heading.

Adjustment of Contracts and Formalise Affaires

DRD17 was sympathetic to the objection that South Africans had specifically chosen to live and work abroad and their decision and way of life was arguably, partly based, on the prevailing tax laws at the time. As such the implementation of the legislation was deferred from 2019 to 2020.

Treasury went further and provided guidance for those affected and a reason as to why the lengthy delay in implementation. The report states, ' To allow greater time for individuals to either adjust their contracts or their circumstances and to finalise or formalise their tax status...'

[7] Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017, 14 September 2017
[8] SARS, Rates of Tax for Individuals 2019
[9] Ibid at 7
[10] Binding General Ruling (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

The point 'adjust their contracts' refers to the option of employees to renegotiate their employment contracts so that they become more balanced i.e. introduce a contractual obligation on the employer in respect of a pensionable element to their contract.

This should not be confused with an employer simply making contributions to a pension from payroll and must be a contractual condition for services rendered. The benefit itself can be paid into a company or personal plan but it must be a contractual obligation of the firm and not form part of remuneration.

Whilst such a renegotiation will result in the employee having a reduced salary it will normalise in part the impact of the additional tax burden, provide more certainty in respect of accumulating a retirement fund and payment from that fund will benefit from the tax exemption on foreign pensions in South Africa[11].

The other benefits of such an arrangement generally include asset protection, pension funds sit outside of the estate and growth in the plan is not subject to tax. In addition funds are invested in hard currency and international markets.

Emigration and Formal Emigration

Emigration is often seen as a way in which to break Residency with South Africa for tax purposes. The reality is that an individual can remain Ordinarily Resident after emigrating from South Africa and establishing permanent residency in another country, albeit the Physical Presence test is failed, which may include giving up their citizenship. It should be noted that Citizenship and nationality only has a bearing on tax where a DTA uses it as a means of defining Residency under a treaty and does not feature in the Income Tax Act or definitions of Ordinarily Resident under common law in South Africa.

This position is confirmed in the DRD17 where it states , 'Individuals who give up their passports may find they are still tax resident in South Africa and may still be liable for South African tax.'[12] It should also be noted that becoming non-resident is a crystallisation event for Capital Gains Tax on the individual's worldwide assets and comes at a significant cost and any income or income producing asset retained in South Africa will be subject to income tax in South Africa for non-residents[13].

THIS SHOULD NOT BE CONFUSED WITH AN EMPLOYER SIMPLY MAKING CONTRIBUTIONS TO A PENSION FROM PAYROLL AND MUST BE A CONTRACTUAL CONDITION FOR SERVICES RENDERED

Formal Emigration on the other hand is the process of becoming non-resident for exchange control purposes and involves getting the necessary Reserve Bank approval and SARS clearances that will allow you to move your funds out of South Africa including South African personal retirement funds, subject to specific tax.

Formal emigration is not required to externalise proceeds of various assets or discretionary funds, these can simply be transferred out using a person's R 1 million discretionary allowance and R 10 million foreign investment allowance.

Expatriates who have formally emigrated but return to South Africa within 5 years of emigrating, it would be considered a 'failed emigration'. The result is the Reserve Bank may require all assets taken out of South Africa are repatriated back to South Africa and SARS may deem all taxes for that period payable.

The Bigger Picture

Research undertaken in the drafting of this bulletin has identified the following;

- a high degree of confusion over the concept of residency which is often confused with matters of citizenship

[11] ibid at 10
[12] ibid at 7, section 9H
[13] ibid at 1

- a lack of understanding of the consequences of becoming non-resident and subsequent tax charges and exchange control implications
- A general absence of structured planning to deal with the protection and passing on of existing wealth or matters of foreign probate and situs
- no strategy for normalising the potential tax on income post 2020

Conclusion

The South African Government has given South African Nationals time to put their affairs into an order that best suits their needs. If the result of such is 'Residency for tax' in South Africa the benefit of the R 1 million exemption provides significant relief. In addition, renegotiating of employment contracts to include contractual pension provision may further assist in normalising their income tax position and benefit from a specific tax exemption on future pension income when returning to South Africa. As for emigration, its an option but it is not a decision to be taken lightly and is probably best considered once certain that one will not fall within definitions of resident as covered above.

Change is inevitable but it's how one adapts and plans for change that is critical. This paper has highlighted certain implications of a changing tax law and the challenge it can create for advisers and their clients. However, such change creates opportunity and emphasises the importance of evolving financial planning to have a greater emphasis on retirement provision as a way to accumulate and protect assets in a compliant an tax efficient manner in order to secure your clients financial future's.

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