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SCHOOL OF ACCOUNTANCY



UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

The income tax provisions that are applicable to foreign employees temporarily working in South Africa

Zukile Dumo Mazwi

A research report submitted to the Faculty of Commerce, Law and Management in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation)

Johannesburg, 2018

ABSTRACT

The taxation of foreign employees who are temporarily working in South Africa has been an area of focus for the South African Revenue Service ('SARS') since the introduction of the SARS special project in July 2010 (www.ensafrica.com, 2010). According to Brand South Africa (www.brandsouthafrica.com, 2002),

> 'global companies with a presence in South Africa cite numerous advantages for setting up shop in the country'.

Having worked for one of the Big 4 Global Audit firms in the expatriate department, it is the author's experience that multinational companies operating in South Africa often utilize expatriate employees for their business needs.

The purpose of this research report is to provide an in depth analysis on the problems with the current income tax provisions that are applicable to expatriates (foreign employees temporarily working in South Africa who are not resident for tax purposes in South Africa) and contrasts the provisions with the SARS practice generally prevailing as detailed in the SARS *Guide on the Taxation of Foreigners Working in South Africa*, SARS interpretation notes and SARS binding private rulings and the tax principles as adopted by the Organisation for Economic Co-operation and Development ('OECD') as published in the *OECD Model Tax Convention on Income and on Capital*.

An analysis of the current tax provisions suggests that income sourcing provisions as found in s 9 (source of income provisions) of the Income Tax Act and interpreted by the South African courts need to be further developed to address remuneration sourcing provisions which will cater for expatriates working in South Africa. Further, the complexity of domestic tax legislation and the Double Tax Agreement provisions make compliance and implementation difficult.

Key words:

Tax, tax residence, gross income, remuneration, expatriate, Double Tax Agreement

DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other university.



Zukile Mazwi

TABLE OF CONTENTS

		Page
ABSTRACT		*2*
DECLARATION		*3*
1	**INTRODUCTION**	*6*
1.1	TAX RESIDENCY	*7*
1.1.1	ORDINARY RESIDENT	*8*
1.1.2	PHYSICAL PRESENCE TEST	*8*
1.2	TAXATION OF EXPATRIATES IN SOUTH AFRICA	*9*
1.3	OBJECTIVES OF THE RESEARCH	*9*
1.4	RESEARCH PROBLEM	*10*
2	**WHAT CONSTITUTES AN EXPATRIATE**	*11*
2.1	INTRODUCTION	*11*
2.2	MEANING OF TAX RESIDENT	*12*
2.2.1	ORDINARILY RESIDENT	*13*
2.2.2	PHYSICAL PRESENCE TEST	*17*
2.2.2.1	THE REQUIREMENTS FOR THE PHYSICAL PRESENCE TEST	*17*
2.2.2.2	WHAT CONSTITUTES A DAY PHYSICALLY PRESENT IN SOUTH AFRICA	*18*
2.2.2.3	DATE ON WHICH A PERSON BECOMES RESIDENT IN TERMS OF THE PHYSICAL PRESENCE TEST	*19*
2.2.2.4	DATE ON WHICH A PERSON CEASES TO BE RESIDENT IN TERMS OF THE PHYSICAL PRESENCE TEST	*19*
2.3	EXCLUSIVE RESIDENT OF ANOTHER STATE	*20*
2.4	END OF CHAPTER SUMMARY	*21*
3	**WHAT ARE THE CURRENT INCOME TAX PROVISIONS THAT ARE APPLICABLE TO EXPATRIATES?**	*22*
3.1	INTRODUCTION	*22*
3.2	GROSS INCOME	*22*
3.3	SOURCE	*24*
3.4	SOURCE OF REMUNERATION	*26*
3.5	SARS' APPROACH TO SOURCING OF REMUNERATION	*27*
3.5.1	OECD MODEL TAX CONVENTION'S APPROACH TO SOURCING OF REMUNERATION	*28*
3.6	SOURCING OF VARIOUS FORMS/TYPES OF REMUNERATION	*29*
3.6.1	SALARY AND BONUS	*30*
3.6.2	CASH ALLOWANCES	*30*
3.6.3	PAYMENT OF AN EMPLOYEE'S DEBT	*32*
3.6.4	DIRECTOR'S FEES	*33*
3.6.5	EQUITY INSTRUMENTS ACQUIRED BY VIRTUE OF EMPLOYMENT	*34*
3.6.6	FREE OR CHEAP RESIDENTIAL ACCOMMODATION	*35*
3.6.7	THE USE OF AN EMPLOYER OWNED MOTOR VEHICLE FOR PRIVATE PURPOSES	*37*

3.6.8 PRACTICAL IMPLICATIONS AND APPROACH TO APPORTIONMENT OF REMUNERATION *38*

3.7 EMPLOYEES' TAX/PAY AS YOU EARN (PAYE) OBLIGATIONS FOR THE EMPLOYER AND THE CHANGE IN THE DEFINITION OF A PROVISIONAL TAXPAYER *40*

3.7.1 SHARE INCENTIVE SCHEMES AND THE RELATED EMPLOYEES' TAX WITHHOLDING *42*

3.8 END OF CHAPTER SUMMARY *45*

4 WHAT ARE THE UNDERLYING PROBLEMS WITH THE CURRENT INCOME TAX PROVISIONS? ***48***

4.1 INTRODUCTION *48*

4.2 THE UNDERLYING PROBLEMS WITH THE CURRENT INCOME TAX PROVISIONS *51*

4.2.1 REMUNERATION SOURCING AND APPORTIONMENT *52*

4.2.2 THE PROVISIONAL TAX METHOD OF TAX COLLECTION FOR EXPATRIATES NOT REPORTED ON A SOUTH AFRICAN PAYROLL *54*

4.2.3 EMPLOYEES' TAX WITHHOLDING ON EMPLOYEE SHARE INCENTIVE SCHEMES *56*

4.3 APPLICATION OF A DOUBLE TAX AGREEMENT *57*
4.3.1 OVERVIEW OF DOUBLE TAX AGREEMENTS *58*
4.3.2 EXPATRIATES WORKING IN SOUTH AFRICA FOR LESS THAN 183 DAYS *59*
4.3.3 ECONOMIC EMPLOYER PRINCIPLE *61*

4.4 END OF CHAPTER SUMMARY *64*

5 HOW CAN THE PROBLEMS WITH THE CURRENT INCOME TAX PROVISIONS BE OVERCOME? ***67***

5.1 INTRODUCTION *67*

5.2 REMUNERATION SOURCING AND APPORTIONMENT *67*
5.2.1 REMUNERATION SOURCING *67*
5.2.2 REMUNERATION APPORTIONMENT *69*

5.3 THE PROVISIONAL TAX METHOD OF TAX COLLECTION FOR EXPATRIATES NOT REPORTED ON A SOUTH AFRICAN PAYROLL *70*

5.4 EMPLOYEES' TAX WITHHOLDING ON EMPLOYEE SHARE SCHEMES ADMINISTERED BY NON-RESIDENT EMPLOYERS *72*

5.5 APPLICATION OF A DOUBLE TAX AGREEMENT WITH REGARD TO EXPATRIATES WHO SPEND LESS THAN 183 DAYS IN SOUTH AFRICA *73*

5.6 END OF CHAPTER SUMMARY *75*

6 CONCLUSION ***78***

6.1 OVERALL CONCLUSION *78*

6.2 AREAS OF FURTHER RESEARCH *81*

7 REFERENCE LIST ***83***

ANNEXURE A - PHYSICAL PRESNCE TEST DIAGRAM ***85***

1. INTRODUCTION

Adam Smith (1776:818) identified four principles (or 'maxims') with regard to taxes in general:

I. 'The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate…

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person…

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it…

IV. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state..'

Haupt (2017:2) states that these maxims, which were formulated in the 1770's, are still relevant today. These tax maxims are discussed further in part 4.1 of this report.

The South African Revenue Service (SARS) is established in terms of the South African Revenue Service Act 34 of 1997. The objectives of the SARS are the collection of revenue in an efficient and effective manner and widest possible enforcement of the national legislation which is administered by the SARS Commissioner (SARS Act, s 3 and s 4).
The SARS Commissioner is responsible for administering the Income Tax Act in terms of s 2 of the Income Tax Act 58 of 1962 ('the Income Tax Act').

In the Republic of South Africa ('South Africa') income tax is levied in terms of the law as laid down in the Income Tax Act and the act in force at present is the Income Tax Act 58 of 1962.

The South African tax system operates on a hybrid source and residency basis. In terms of the gross income definition in s 1(1) of the Income Tax Act, the basic principle is that residents of South Africa are potentially liable for tax on their worldwide receipts and accruals.
The gross income definition in s 1(1) of the Income Tax Act under para *(n)* provides that gross income includes any other amount received or accrued in terms of any other provisions of the Income Tax Act which is specifically required to be included in the taxpayer's income.
To this regard, s 26A of the Income Tax Act provides that the taxable capital gain shall be included in the taxable income of a person for a year of assessment as determined in terms of the Eighth Schedule to the Income Tax Act.

On the other hand, the gross income definition in s 1(1) of the Income Tax Act provides that non-residents are only liable for income tax on their receipts and accruals that are from (or deemed to be from) a South African source.
Non-residents are liable for income tax on their taxable capital gains in terms of s 26A of the Income Tax Act as determined in terms of the Eighth Schedule to the Income Tax Act.
Taxable capital gains with regard to non-residents applies to immovable property (or an interest in such property) located in South Africa as provided in paras 2(*b*), 3 and 4 of the Eighth Schedule to the Income Tax Act.
For this reason it is important to determine whether a person is a resident or non-resident for South African tax purposes.

1.1 Tax residency

In respect of individuals, a 'resident' is defined in s 1(1) of the Income Tax Act as meaning any:

- Natural person who is ordinarily resident in South Africa; or
- A natural person who is not, at any stage during the relevant year of assessment, ordinarily resident in South Africa, but who:
    - is physically present in South Africa for a period or periods exceeding 91 days (or part days) in aggregate during the current year of assessment as well as for a period exceeding 91 days (or part days) in aggregate during each of the five preceding years of assessment; and
    - was physically present in South Africa for a period exceeding 915 days (or part days) in aggregate during the preceding five years of assessment.
      This is referred to as the 'physical presence test'.

The definition of resident in the Income Tax Act further provides that the term resident -

> 'does not include any person who is deemed to be exclusively a resident of another country for the purposes of the application of any agreement entered into between the governments of South Africa and that other country for the avoidance of double taxation.'

For purposes of this research report an 'expatriate' is a foreign employee temporarily working in South Africa who is not resident for tax purposes in South Africa.

1.1.1 Ordinary resident

SARS Income Tax Interpretation Note no 3 (2002: 2) states that the Income Tax Act does not define 'ordinarily resident', and therefore the interpretation given by the courts must be followed. SARS (2002: 3) goes further to say that the South African courts have determined the concept to mean the country to which a person would naturally and as a matter of course return from his/her wanderings. This topic will be examined further in chapter two of this research report.

In other words, if an individual comes to South Africa on assignment/secondment (whether of short or long-term duration) but always intends returning to his home country, he will most likely not become ordinarily resident in South Africa. The preceding statement is applicable to individuals who do not intend to create a permanent home in South Africa.

However, it is important to note that even if an individual is not ordinarily resident in South Africa, an extended stay in South Africa could result in the individual triggering residence for tax purposes in terms of the physical presence test subject to any determination of exclusive tax residency elsewhere under a double tax agreement (*SARS Income Tax Interpretation Note no 4* 2014: 4).

1.1.2 Physical presence test

In terms of the definition of a resident in s 1(1) of the Income Tax Act read with the *SARS Income Tax Interpretation Note no 4* (2014: 4), the effect of the definition of a 'resident' is that a natural person who is not ordinarily resident in South Africa can, in terms of the physical presence test, only become a resident for tax purposes at the beginning of the sixth year of assessment provided the person was physically present in South Africa for the five preceding years of assessment (and satisfies the other qualifying criteria as set out in part 1.1 above).

In terms of the definition of a resident in s 1(1) of the Income Tax Act, residency in terms of the physical presence test will only be triggered if an 'expatriate' has spent five years of

assessment in South Africa (and is entering their sixth year of assessment being physically present in South Africa) and has been physically present in South Africa for more than 91 days (or part days) in aggregate during the current year of assessment as well as for a period exceeding 91 days (or part days) in aggregate during each of the five preceding years of assessment; and was physically present in South Africa for a period exceeding 915 days (or part days) in aggregate during the preceding five years of assessment.
SARS (2014: 8) specifies that should an expatriate trigger South African tax residency in terms of the physical presence test, and at that point still be regarded as a tax resident of another country under its domestic law, the provisions of the double tax agreement between South Africa and that country will have to be considered. This topic will be covered in more detail in chapter two of this research report.

1.2 Taxation of expatriates in South Africa

As indicated above, in terms of the gross income definition in s 1(1) of the Income Tax Act, expatriates (foreign employees temporarily working in South Africa who are not resident for tax purposes in South Africa) are only taxable in South Africa on their South African sourced receipts and accruals and capital gains in respect of immovable property (or an interest in such property) situated in South Africa.

Paragraphs *(c*), *(d)* and *(i)* of the gross income definition in s 1(1) of Income Tax Act are specific inclusions of remuneration earned for services rendered into gross income.

According to Haupt (2017: 36) determining the source of income becomes relevant since non-residents (expatriates) are taxable in South Africa on South African sourced receipts and accruals.

Stiglingh, Koekemoer, van Zyl, Wilcocks and de Swardt (2017: 74) state that difficulties may arise in locating the source of income if the activities that result in the income being received are performed in South Africa and in one or more other countries.

1.3 Objectives of the research

The essence of this research report is to critically analyze the difficulties in locating the source of remuneration, remuneration apportionment, the application of Double Tax Agreements and employees' tax withholding in relation to expatriates and contrast these with the SARS practice generally prevailing as detailed in the SARS *Guide on the Taxation of*

Foreigners Working in South Africa (2014/15), SARS Interpretation Notes numbers 3, 4 and *SARS Binding Private Rulings numbers 65, 85, 153* and *156*. This research report will further analyze and contrast the SARS practice generally prevailing with the tax principles of remuneration sourcing as adopted by the 2008 *OECD Model Tax Convention on Income and on Capital*. Lastly, the purpose of the research report is to provide recommendations on how the South African domestic legislation provisions could be updated to address the current short comings in relation to the taxation of expatriates.

1.4. Research problem

What are the problems with the current income tax provisions that are applicable to expatriates and how these problems can be overcome?
The report will achieve its objectives by addressing the following sub-problems:

- What constitutes an expatriate?
- What are the current income tax provisions that are applicable to expatriates?
- What are the underlying problems with the current income tax provisions?
- How can the problems with the current income tax provisions be overcome?

In order to provide certainty and clarity where uncertainty exists, the Commissioner often issues interpretation notes which set out SARS' practice in interpreting or applying certain provisions of the Income Tax Act (Haupt 2017: 14). This is the reason why this research report will focus on SARS' official publications as they convey SARS' 'practice generally prevailing' in terms of s 5 of the Tax Administration Act 28 of 2011 ('Tax Administration Act').

2. What constitutes an expatriate?

2.1 Introduction

For purposes of this research report an 'expatriate' is a foreign employee temporarily working in South Africa who is not resident for tax purposes.

It is important to determine whether a person is a resident or non-resident for South African tax purposes as this in essence determines how an individual and/or expatriate will be taxed in South Africa which is why the question of tax residence is important and must be considered in this research report.

De Koker, A. and Williams, R.C. (2017: 5-2) state that

> 'The fiscal jurisdiction of a State is premised upon a legally relevant connection or fiscal attachment between the State and the taxpayer, which links that taxpayer to the particular fiscal jurisdiction… According to international usage, a jurisdictional claim based on such a legally relevant connection or prescribed nexus between the State making that claim and the person being subjected to tax, is referred to as "residence taxation"…
> In contradistinction to a jurisdictional claim based on "residence taxation" is the concept of "source taxation".'

De Koker and Williams go further to state that (2017: 5-2) source taxation is precisely what it says: an imposition upon income arising within the jurisdiction.

> 'In the case of natural persons, residence taxation embraces concepts of "political allegiance", "nationality" (which is usually understood as equivalent to citizenship), and "residence", encompassing both "ordinary residence" and "domicile". Thus, for natural persons, tax jurisdiction is based primarily on a predominant physical presence within that jurisdiction' (De Koker and Williams 2017: 5-2).

According to De Koker and Williams (2017: 5-3), South Africa applies a residence-based (or worldwide) system of taxation (as from 1 January 2001). The aforementioned authors explain that (2017: 5-3) the residence basis of taxation means that receipts and accruals of income derived by 'residents' from all sources are subject to tax, but certain limited categories of income arising from activities undertaken outside the Republic are exempt from tax.
The term 'Republic' is defined in s 1 of the Income Tax Act and may be summarized as meaning the Republic of South Africa including its territorial sea and any area designated

under international law and the laws of South Africa as areas within which South Africa may exercise sovereign rights or jurisdiction.

For 'non-residents', that is, persons who do not exhibit the nexus adopted for residence taxation, only receipts and accruals of income derived from sources in the Republic are subject to tax (De Koker and Williams 2017: 5-3).

De Koker and Williams (2017: 5-3) state that

> 'this basis of taxing 'non-residents' relies upon a connecting factor of which the referent is the character of the income, rather than the person who earns it. This is commonly referred to as "source taxation"…
>
> Liability for tax is therefore generally dependent either upon the place of residence of a person or, in the case of non-residents, upon the source or deemed source of the income.'

The preceding paragraphs highlight that there is a difference between the tax principles applicable to residents and non-residents. Therefore, it is imperative that this report examines the meaning of both these terms namely 'resident' and 'non-resident' as defined in the Income Tax Act as introduced in part 1.1 above.

2.2 Meaning of (tax) resident

In respect of individuals the following persons are defined as being 'resident' in terms of s 1(1) of the Income Tax Act:

- A natural person who is ordinarily resident in the Republic, or
- A natural person who is not, at any stage during the relevant year of assessment, ordinarily resident in South Africa, but who meets the requirements of the physical presence test as explained in part 1.1.2 above (De Koker and Williams 2017: 5-5).

The definition of resident in s 1(1) of the Income Tax Act further provides that the term resident -

> 'does not include any person who is deemed to be exclusively a resident of another country for the purposes of the application of any agreement entered into between the governments of South Africa and that other country for the avoidance of double taxation.'

De Koker and Williams (2017: 5-5) explain that:

> 'This effective exclusion (which applies to both natural persons and persons other than natural persons) applies only if the person in question is deemed, in terms of a double tax agreement, to be exclusively a resident of the other country which is a party to the agreement. If so, then even though that person in

other respects fulfils the statutory criteria for residence in the Republic, he is not – to the extent that the double tax agreement applies – a resident of the Republic for purposes of the Act.'

2.2.1 Ordinarily resident

'Ordinary residence' requires an intention to live in a place at a particular point in time, for a significant period, with the place being his or her real home for that time (Haupt 2017: 25). Haupt also states that (2017: 25) this intention also has to be carried out.
The Income Tax Act does not define 'ordinarily resident', and therefore the interpretation given by the courts must be followed (SARS 2002: 2).

In *Cohen v CIR* 1946 AD 174, 13 SATC 362, a summary of the facts as contained in the judgement are as follows (1946:362):

'Appellant, who was domiciled in the Union, and was one of two directors of a company carrying on business in the Union, was requested by his company to go overseas to act as the company's buyer, in view of the difficulty of obtaining merchandise, caused by war conditions.
Appellant left the Union in June, 1940, accompanied by his family. The permit authorising his departure contained the words "duration 9 months". In October, 1940, he arrived in the United States of America and established his family in an apartment in New York, where he carried on the business operations which were the purpose of his visit.
In 1941, appellant was granted an extension of 12 months in respect of his permit to remain in America. From that date and up to the 30th June, 1942, neither appellant nor his family had returned to the Union.
In 1939, appellant had leased a flat in Johannesburg for a period of 5 years and had furnished it. This flat had been sublet, with the furniture, during the period for which appellant had been in America.'

The summary of the judgement on the *Cohen v CIR* case (1946: 363) states the following:

'The appellant was assessed to super tax on certain dividends from public companies in respect of the year of assessment ending the 30th June, 1942. Throughout the whole of that year he was out of the Union and he appealed to the Special Court against the assessment in respect of the abovementioned dividends on the ground that they were exempt from super tax in terms of sec 30(1)(a) of Act 31 of 1941. The provision in question reads: "There shall be exempt from super tax(a) dividends, distributed by a public company, received by or accrued to or in favour of or apportioned in terms of paragraph(b) of section thirty seven to an individual not ordinarily resident nor carrying on business in the Union".'

Dismissing the appeal in the Cohen case (1946: 362), the court held as follows:

'that the question whether an individual was resident or ordinarily resident in any particular area for the purposes of the Income Tax Act was one of fact and that there was clearly evidence upon which the Special Court was entitled to find that appellant had not proved that he was not ordinarily resident in the Union;

> Held, further, that the question whether an individual was in any one year of assessment ordinarily resident in the Union or elsewhere was not to be determined solely by his actions during that year of assessment; his conditions of ordinary residence during that year could be determined by evidence as to his mode of life outside the year of assessment under consideration;
>
> Held, further, that physical absence during the whole of the year of assessment was not decisive of the question of "ordinary residence".'

In the judgment in *Cohen v CIR* (1946 :371), the judge gave a meaning to the words 'ordinary residence':

> '…his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings; as contrasted with other lands it might be **called his usual or principal residenc**e and it would be described more aptly than other countries as his real home.'

Haupt's (2017: 27) interpretation of the finding of the Cohen case is that the test of ordinary residence is not limited to a single year. Haupt (2017: 27) further states that:

> 'the court stated that the question of ordinary residence was a question of fact, and a question of degree. It implied that every person must have a residence somewhere (on land), and it appeared to the court that Mr Cohen's residence was South Africa, because it took the view that his stay outside South Africa was temporary.'

SARS (2002:3) observes that in ITC 1170 (34 SATC 76) it was pointed out by the court that the question whether a taxpayer may be regarded as being 'ordinarily resident' at a particular place during a particular period is one of degree, and one is entitled to look at the taxpayer's mode of life beyond the particular period under consideration.

Another leading domestic case on determining ordinary residence is *CIR v Kuttel* 1992 (3) SA 242 (AD), 54 SATC 298. The judge in this case (1992: 298) upheld the meaning of ordinarily resident as it was established in the Cohen case:

> 'I would respectfully adopt the formulation of Schreiner JA and hold that a person is 'ordinarily resident' where he has his usual or principle residence, i.e. what may be described as his real home…
> The respondent's visits to South Africa were not for purposes which one would normally associate with a "return home". They were primarily for business purposes relating to his companies and the building of the yacht which began prior to his decision to emigrate…
> The fact that the respondent kept his house at Llandudno is in no way inconsistent with his usual or principal residence or home having been in the United States. He had sound financial reasons for retaining an interest in immovable property and he required a place to live when he visited Cape Town.

In other words, he retained a residence in Cape Town and that was quite consistent with his ordinary residence being in the United States.'

Following the above cases which set the precedence for determining ordinary residence, SARS through the publication of *SARS Income Tax Interpretation Note no 3(2002)* has established the following principles/guidelines (SARS 2002: 5) to help them to decide on whether a natural person is ordinarily resident in South Africa or not:

'A physical presence at all times is not a requisite to be ordinarily resident in the Republic. The following two requirements need to be present:

- an intention to become ordinarily resident in a country; and
- steps indicative of this intention having been or being carried out.

The following factors will be relevant in considering the above two requirements:

- most fixed and settled place of residence
- habitual abode, i.e. present habits and mode of life
- place of business and personal interest
- status of individual in country, i.e. immigrant, work permit periods and conditions, etc.
- location of personal belongings
- nationality
- family and social relations (schools, church, etc.)
- political, cultural or other activities
- application for permanent residence
- period abroad; purpose and nature of visits
- frequency of and reasons of visits

The above list is not intended to be exhaustive or specific, merely a guideline.'

A case which is useful and relevant, as it is related to the topic of this research report is ITC 1807 (2006) 68 SATC 154. The court dealt with the issue of a person who moved from the United Kingdom to South Africa temporarily for the purposes of a two year work-assignment. The court in ITC 1807 held (2006:156) that the term 'usual place of residence' used in paragraph 9(7) of the Seventh Schedule to the Income Tax Act meant the taxpayer's place of ordinary residence, and this was the United Kingdom, because he was in South Africa temporarily.

The judgment in ITC 1807 (2006:156) suggests that if an expatriate is in South Africa temporarily and does not consider South Africa as his/her real home or a place to which he/she will return to from his/her wanderings, the expatriate will not become ordinarily

resident in South Africa for tax purposes. This is confirmed by the ruling made by SARS in the *SARS Binding Private Ruling number 65* (2009:3) where an expatriate was in South Africa for a short term assignment of two years renewable annually thereafter. The facts of the *SARS Binding Private Ruling number 65* are as follows:

- The expatriate relocated to South Africa with his wife and children,
- He bought a house in South Africa and had sold his property in his country of birth.
- At this stage, he regards his country of birth as his real home, that is, the place to which he will return once the South African employment contract terminates.

The ruling states that:

> 'the Applicant must inform the Advanced Tax Ruling division immediately if his stated intention changes and he decides to stay in South Africa on a permanent basis…The Applicant will not be regarded as ordinarily resident for purposes of the definition of "resident" as contained in section 1 for the two year period that he will be employed by Company A.'

SARS Binding Private Ruling number 153 (2013:2) notes that:

> 'An application for a retired person's permit will not, in itself, be sufficient for the Applicant to become ordinarily resident in South Africa provided the Applicant does not indicate to the Department of Home Affairs on the relevant application form(s) that the intention is to settle in South Africa on a permanent basis.'

The established principles are that even if a person is absent from his home country for more than a year, he could still be treated as ordinarily resident there, provided that his absence was temporary (Haupt 2017:27).

A leading case in Canada, *Thompson v Minister of National Revenue* 2 DTC 812 (SCC) on the interpretation of the meaning of 'ordinarily resident', held as follows (SARS 2002: 2):

> 'In this case it was held that a person is ordinarily resident in the place "where in the settled routine of his life he regularly, normally or customarily lives" or "at which he in mind and in fact settles into or maintains or centralises his ordinary mode of living with its accessories in social relations, interest and conveniences".'

It is submitted that the meaning of ordinarily resident as interpreted and established by the South African courts is in line with OECD thinking since the OECD tie-breaker clauses

operate similarly to the ordinarily residence test i.e. the objective of the tie-breaker is to determine a person's real home.

2.2.2 Physical presence test

If a person is not ordinarily resident in the Republic at all during a year of assessment, he will be treated as resident for tax purposes during the year if he spent a prescribed amount of time in the Republic (Haupt 2017:27). A further emphasis made by Haupt (2017:27) is that the physical presence test is not the primary test of residence, it is subsidiary to the ordinary residence test.
In other words, the 'ordinarily residence' test supersedes the physical presence test (SARS 2014:2).

Haupt (2017:27) confirms that if a person is ordinarily resident in South Africa, it does not matter how many days the person has spent in the country, it is only if a person is not ordinarily resident in South Africa that this test could deem him or her to be resident, having spent more than a certain number of days in the country over a period of 6 years.
The physical presence test is thus not applicable during any year of assessment that a person is ordinarily resident in the Republic (SARS 2014: 2).

De Koker and Williams (2017: 5-6-1) explain that the 'physical presence' test is an alternate test deeming residence to occur with reference to a day counting rule.
According to *SARS Income Tax Interpretation Note no 4* (2014: 2), the physical presence test, also known as the 'day test' or 'time rule', is based on the number of days that a natural person is physically present in the Republic. SARS (2014: 2) confirms that the purpose or nature of the visit is irrelevant. SARS (2014: 2) further notes that it must be determined annually whether all the requirements of the physical presence test have been met.

De Koker and Williams (2017: 5-5) add that where a person gives up his principal residence and ceases to be ordinarily resident in the Republic, the physical presence test starts operating only in the year of assessment after that in which he ceases to be ordinarily resident.

2.2.2.1 The requirements for the physical presence test:

Section 1(1) of the Income Tax Act in para (*a*)(ii) of the definition of resident states that a natural person who is not ordinarily resident in South Africa will fall into the definition of resident as noted in part 1.1.2 above if:

- that person has been physically present in South Africa for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, and
- if that person was physically present in South Africa for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment, and
- if that person was physically present in South Africa for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment.

The definition of resident in s 1(1) of the Income Tax Act makes two provisos with regard to the physical presence test which De Koker and Williams (2017: 5-5) paraphrase as:

> 'a) for the purposes of determining the number of days during which a person is physically present, a day includes part of a day but excludes any day in transit through the Republic between two places outside the Republic if he does not formally enter the Republic through a "port of entry" as "contemplated in" s 9(1) of the Immigration Act 13 of 2002 or at any other place as may be permitted by the Director-General or the Minister of the Department of Home Affairs in terms of the same Act (proviso (A) to para (a)(ii) of the definition of 'resident' in s 1 (of the Income Tax Act). The expression 'in transit between two places outside the Republic' means that the point of departure and the point of destination of the specific journey that is being undertaken must be outside the borders of the Republic. and
>
> b) a person who is a resident because of physical presence ceases to be such from the day he ceases to be physically present in the Republic, if he remains outside the Republic for a continuous period of at least 330 days .'

2.2.2.2 What constitutes a day physically present in South Africa

SARS (2014: 2) explains that under proviso (A) to the definition of a 'resident' a day includes a part of a day. SARS (2014:2) explains that a day begins at 00:00 and ends at 24:00. A person who arrives in the Republic at 23:55 would thus be regarded as being physically present in the Republic for one day, even though that person was only present for five minutes of that day. For this reason, both the day of arrival and departure, as indicated in the person's passport, are included in the count of the number of days (SARS 2014: 2).

The 91-day and 915-day periods of physical presence in the Republic need not be continuous (De Koker and Williams 2017:5-5). If a person is present for several intermittent periods, which in aggregate exceed 91 or 915 days in the preceding five years of assessment, residence will be established (De Koker and Williams 2017:5-5).

2.2.2.3 Date on which a person becomes resident in terms of the physical presence test

SARS (2014:2) states that a person will be a resident with effect from the first day of the relevant year (that is, the sixth year) during which all the requirements of the physical presence test have been met.

De Koker and Williams (2017:5-5) hold the position that a person can become a resident only in the sixth (the current) year in which he conforms to the requisite periods of physical presence test. They (De Koker and Williams 2017:5-5) hold the view that in other words, the definition requires six successive qualifying tax years to become a resident. SARS holds the same view (SARS 2014:5) i.e.

> 'A person will be resident with effect from the first day of the relevant year (that is, the sixth year during which all the requirements of the physical presence test have been met'.

De Koker and Williams (2017:5-5) add that

> 'if the person is physically present in the Republic for 91 days or less in any of these six years, the chain is broken with the result that he avoids becoming a resident – and therefore will not be liable for tax on worldwide income – in the Republic…
>
> the six-year cycle would then commence from the first subsequent tax year in which the non-resident is physically present in the Republic for the requisite period.'

A person who has met the requirements of the physical presence test and is therefore resident will be subject to tax in the Republic on worldwide income received or accrued from the first day of that year of assessment (SARS 2014:5). In other words,

> 'he will become liable for normal tax and the so-called capital gains tax on his worldwide receipts and accruals and assets' (De Koker and Williams 2017: 5-5).

2.2.2.4 Date on which a person ceases to be resident in terms of the physical presence test

In terms of proviso (B) to the definition of a 'resident' in s 1(1) of the Income Tax Act a natural person, who is resident by virtue of the physical presence test, ceases to be a resident when that person is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic. Residence will cease from the day after the person left the Republic (SARS 2014:6).

Annexure A contains an illustration of how the physical presence test applies.

2.3 Exclusive resident of another state

The definition of a 'resident' in section 1(1) of the Income Tax Act states that any person who is exclusively deemed to be a resident of another country for the purposes of the application of a double tax treaty between that country and South Africa is not a resident as defined.
Haupt (2017: 25) states that if a person is deemed to be resident of another country for purposes of the application of the double tax agreement which South Africa has with that other country, he or she is deemed not to be resident of South Africa, even if the other tests apply namely, the ordinarily residence test and the physical presence test.

SARS (2014: 8) states that a person who is exclusively deemed to be a resident of a country other than the Republic under a tax treaty (as a result of the tax treaty tie-breaker rules or otherwise), is not a resident for purposes of the Act, regardless of any other rules in the definition of a 'resident' in s 1(1) of the Income Tax Act.

The tie-breaker rules (clauses) referred to above are found in the *OECD Model Tax Convention on Income and on Capital* (2008:24) and the various double tax agreements many of which are based on the OECD model (Haupt 2017:631). The tie-breaker rules will determine which country, for the purposes of the treaty, the individual is exclusively resident of.

The following is a list of the tie-breaker rules as established in the *OECD Model Tax Convention on Income and on Capital* (2008:24) which are applied in order to determine a person's country of exclusive residence:

> 'a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
> b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has a habitual abode;
> c) if he has a habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
> d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.'

It is the author's view that the tie-breaker rules operate similarly to the ordinarily residence test i.e. the objective of the tie-breaker is to determine a person's real home.

2.4 End of chapter summary

As noted previously in ITC 1807 (2006: 156), if an expatriate is in South Africa temporarily and does not consider South Africa as his/her real home or a place to which he/she will return to from his/her wanderings, the expatriate will not become ordinarily resident in South Africa for tax purposes.

SARS Binding Private Ruling number 153 (2013) notes that an application for a permit to stay in South Africa will not automatically render an individual ordinarily resident in South Africa provided the applicant does not indicate to the Department of Home Affairs that the intention is to settle in South Africa on a permanent basis.

However, an expatriate may become resident for tax purposes in South Africa in terms of the physical presence test should he/she meet the days requirements, that is, an expatriate will satisfy the physical presence test in the sixth year of assessment being physically present in South Africa provided he/she were not ordinarily resident in South Africa at any stage within the preceding 5 years of assessment. This is also confirmed in *SARS Binding Private Ruling number 65* (2009: 3, para 2 under subsection 5):

> 'the Applicant may become a resident for purposes of the Act under the physical presence test as contained in the definition of "resident" in section 1.'

Therefore, in terms of s 1 of the Income Tax Act under the definition of gross income, expatriates are only taxable in South Africa on their South African sourced receipts and accruals.

Non-residents are also liable for income tax on their taxable capital gains in terms s 26A of the Income Tax Act as determined in terms of the Eighth Schedule to the Income Tax Act. Taxable capital gains with regard to non-residents applies to immovable property (or an interest in such property) located in South Africa as provided in paras 2(*b*), 3 and 4 of the Eighth Schedule to the Income Tax Act.

3. What are the current income tax provisions that are applicable to expatriates?

3.1 Introduction

The definition of the term 'gross income' in s 1(1) of the Income Tax Act is central to the whole of the Income Tax Act (De Koker and Williams 2017:1-14).
Gross income is defined in relation to a year of assessment (De Koker and Williams 2017:1-14).

A year of assessment is defined in s 1 of the Income Tax Act as meaning any year or other period in respect of which any tax is chargeable under the Income Tax Act.

The year of assessment for individuals runs from the beginning of March in one year to the end of February in the following year (SARS *Guide on the Taxation of Foreigners Working in South Africa (2014/15),* 2015:7).

This chapter will focus on the meaning of gross income in relation to an expatriate. This research report will not cover exempt income (income that may be received by or accrued to a person on which tax is not imposed) and deductions which an individual is allowed to deduct against gross income.

3.2 Gross income

As noted in part 1.2 of this document, expatriates are taxable in South Africa on their South Africa sourced receipts and accruals.
According to the *SARS Guide on the Residence basis of taxation for individuals (2008/09)*:

> 'the term "taxable income" as defined in section 1(1) of the Income Tax Act is used to describe the amount on which normal tax payable is calculated. The starting point in calculating taxable income is to determine the amount of gross income, which represents the total amount, in cash or otherwise (excluding receipts or accruals of a capital nature), received by or accrued to a person, from which the aggregate amount of certain exemptions are deducted to arrive at the amount of income. The aggregate amount of allowable deductions are deducted from the amount of income, and the amount of all taxable capital gains are added to the amount of income in order to arrive at the amount of taxable income.'

According to Haupt (2017:17), the general framework for the calculation of taxable income indicates that the starting point in the income tax calculation is gross income. Haupt further explains (2017:17) that if a person does not have gross income, such person will not have to

pay normal income tax. It is that author's view that this can only be the case if the person also does not have any taxable capital gains.

The term gross income is defined in the Income Tax Act in s 1(1) as follows:

> 'Gross income in relation to any year or period of assessment, is defined as:
> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
> (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,
> during such year or period of assessment, excluding receipts or accruals of a capital nature . . .'

De Koker and Williams (2017: 5-13) state that the term source as reported in subparagraph (ii) of the definition of gross income above means the originating cause of the receipt or accrual (taxable income) and that the problem with determining the source of taxable income involves an inquiry into two matters, namely what is the originating cause of the income and is the originating cause in the Republic? The concept of source is discussed further in sections 3.3 to 3.6 of this research report below.

De Koker and Williams (2017: 1-14) state that the definition of gross income then lists certain amounts specifically included in gross income, which are set out in paragraphs (*a*) to (*n*) of the definition of the term 'gross income' in s 1 of the Income Tax Act.

Remuneration for services rendered is specifically included into gross income in terms of paragraph (*c*) and paragraph (*i*) of the gross income definition in s 1 of the Income Tax Act. Paragraph (*c*) of the gross income definition provides as follows:

> *'(c)* any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered or any amount (other than an amount referred to in section 8 (1), 8B or 8C) received or accrued in respect of any employment or the holding of any office: Provided that—
>
> *(i)* 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;…
> *(ii)* any amount received by or accrued to or for the benefit of any person in respect of services rendered or to be rendered by any other person shall for the purposes of this definition be deemed to have been received by or to have accrued to the said other person;'

Paragraph *(i)* of the gross income definition provides as follows:

> '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;'

Paragraph (*c*) provides that all amounts received in respect in respect of services rendered or to be rendered, or in respect of (or by virtue of) employment, whether such amounts are capital or revenue in nature, are included in gross income (Haupt 2017:66).

Therefore, expatriates are potentially taxable on South African sourced remuneration which forms part of their gross income (paras (*c*) and (*i*) of the definition of gross income) together with South African sourced investment income which ultimately makes up their South African sourced taxable income.

Paragraph 1 of the Fourth Schedule to the Income Tax Act provides that remuneration means:

> 'any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered, including—
> (a) any amount referred to in paragraph (a), (c), (cA), (cB), (d), (e), (eA) or (f) of the definition of "gross income" in section 1 of this Act;
> (b) any amount required to be included in such person's gross income under paragraph (i) of that definition, excluding an amount described in paragraph 7 of the Seventh Schedule…
> (e) any amount referred to in section 8C which is required to be included in the income of that person…'

3.3 Source

As discussed in the previous chapter and part 3.2 above, non-residents are potentially taxed in South Africa on their gross income which is from a South African source in terms of the definition of gross income in s 1(1) of the Income Tax Act. The source basis of taxation means that expatriates are taxed in South Africa if the source of their taxable income (receipts and accruals) is located in South Africa (Haupt 2017:36).
Since non-residents are taxed in South Africa only on South African sourced receipts and accruals, it is therefore, critical to determine the meaning of 'source'.

There is no definition in the Income Tax Act of the term 'source', the reason no doubt being that it is not possible to define satisfactorily the qualities that will determine the source of income in all circumstances (De Koker and Williams 2017: 5-13).

Consequently, it is for the courts to decide on the particular facts of each case whether income has or not has been received from a source within South Africa (De Koker and Williams 2017: 5-13).

The test for source was formulated in the *CIR v Lever Brothers and Unilever Ltd* 1946 AD441, 14 SATC 1 case.

According to the *CIR v Lever Brothers and Unilever Ltd* case (1946:8-9), in determining the source of income, the originating cause of the income must first be established and then the location of the originating cause must be determined:

> '…the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else.'

Haupt (2017:42) states the principal test of the source of income as the **originating cause** of the income arising as established in the *CIR v Lever Brothers and Unilever Ltd* case.

Haupt (2017:42) states that (in the *CIR v Lever Brothers and Unilever Ltd* case) the court therefore felt that two factors had to be established in determining the source of income:

- the originating cause of the income, i.e. what gives rise to the income; and
- the location of the originating cause

De Koker and Williams (2017:5-13) also confirm this and concludes that

> 'source means the originating cause and that the problem involves an inquiry into two matters, namely what is the originating cause of the income and is the originating cause in the Republic?'

In *CIR v Black* 1957 (3) SA 536 (A), 21 SATC 226 (1957: 233) it was found that if there is more than one originating cause, it is necessary to establish the dominant cause. Schreiner ACJ in delivering his judgment on this case (*CIR v Black* 1957:233) stated that:

> 'it was accepted that if it could be shown "that the only true and reasonable conclusion on the facts found was that the dominant, or main or substantial or real and basic cause of the accrual of income was to be found" in South Africa, the source of that income would be in South Africa.'

3.4 Source of remuneration

Haupt (2017: 43) states that it is an established principle that the source of income from services rendered is located where the services are rendered. Haupt further states (2017:43) that

> 'the "originating cause" (as established in CIR v Lever Brothers and Unilever Ltd case) is the rendering of the services which is the quid pro quo in respect of which the income is received. The source of the income is not dependent on where the service contract is signed or where the payment is made.'

De Koker and Williams (2017: 5-22) confirm that the Special Court for Hearing Income Tax Appeals (now the Tax Court) has consistently held, for example in ITC 77 (discussed below), that

> 'the source (in the sense of the "originating cause") of income from employment and other services rendered is the services, irrespective of the place where the contract is made or the remuneration is paid. The source of the remuneration would therefore be located at the place where the services are rendered.'

The general principles relating to the actual source of income from employment were well set out in the form of these practical illustrations by G J Maritz, the President on page 73 of 3 ITC 77 (1927) 3 SATC 72 (U):

> '1. An attorney who practised in the Free State employed a clerk at a salary of £500: the source of the clerk's income of £500 would be the Union, for his services were located there.
> 2. An attorney who practised both in the Free State and in Basutoland, employed a clerk to work in both businesses at a salary of £500: the locality of the services which earned the £500 would be partly in the Free State and partly in Basutoland. An allocation would have to be made, probably on a time basis, of the £500, partly to a Union source, and partly to a Basutoland source.
> 3. An attorney who practised in the Free State near the Basutoland border, employed a clerk at £500 per annum to serve him in his Free State business. The clerk, however, occasionally crossed the border to perform casual work for his employer in Basutoland. The locality of the services which earned the £500 would be the Free State, because the contract stated that the services for which he is paid £500 was in the Free State. The acts of service performed by the clerk in Basutoland were casual and accidental in their nature, and were not remunerated as such. If, however, the attorney remunerated him specially for the acts of service he performed in Basutoland, then the locality of the service which produced that special remuneration would be Basutoland, and the source of the special remuneration would be Basutoland. ..'

In the application of the source tests, regard must be had to the contract of employment in order to ascertain whether the employee has contracted to render services both within and outside the Republic. If he has so contracted, the remuneration relating to the services

rendered outside the Republic would not be from a South African source. But if he has not contracted to render services outside the Republic, the full remuneration must be from a Republic source, even though occasional or casual services are performed outside the Republic. In these circumstances regard must be had to the contract as a whole and not to incidents connected with the contract. (De Koker and Williams (2017: 5-22 to 5-23).)

According to the commentary on the *OECD Model Tax Convention on Income and on Capital* article 15 (2008:210), the source of remuneration, employment income or income earned for services rendered is generally accepted to be located where the services yielding the income are physically performed. This is irrespective of where in the world an individual may be paid for these services, where his / her employment contract is signed or where his / her employer is situated (*OECD Model Tax Convention on Income and on Capital* 2008: 210, paragraph 2.2).

3.5 SARS' approach to sourcing of remuneration

Based on an analysis of SARS' practice, it seems that SARS' approach to sourcing of remuneration is to distinguish between core and non-core/accidental/subsidiary or incidental employment services (SARS *Guide on the Taxation of Foreigners Working in South Africa (2014/15)*, 2015:10). SARS (2015:10) states that while it is accepted that it is correct to apportion income if it is clear that it is derived from more than one source, if the services rendered outside of South Africa by the expatriate are merely casual and accidental or subsidiary and incidental then the source of the employment income will be fully South African.
SARS (2015:5) states that income received by a foreigner (expatriate) for services rendered inside and outside South Africa could be apportioned based on the number of days worked in and outside of South Africa during a year of assessment.
The correct test of source for employment income is to determine what services the employee was engaged to perform, and then to determine the location where those services were required to be rendered (SARS 2015:10).

SARS's guide (2015:10) further states that since the amount of income to be apportioned between South Africa and the foreign jurisdiction is determined by where the services are rendered, and not just where the foreigner is present, SARS accepts that work days, as opposed to total days, is the correct method to apportion the foreigner's income if a part of

the income is not from a source in South Africa. This approach may be illustrated as follows (SARS 2015:10):

$$\frac{\text{Work days inside South Africa}}{\text{Total work days for the period}} \times \text{Employment income earned}$$

"Work days" does not include weekends, public holidays or leave days. Only days of actual services rendered are considered. To the extent that incidental work days outside of South Africa are regarded as being from a source within South Africa, those days must be considered to be work days inside South Africa.

SARS states that (SARS 2015:11):

> 'all amounts received in respect of employment may qualify for apportionment, including cash, allowances and taxable benefits granted in respect of the employee's employment, **unless the taxable benefit is received for exclusive use in South Africa' (**emphasis added).

The remuneration apportionment condition stated in the SARS guide (SARS 2015:11), namely that '**unless the taxable benefit is received for exclusive use in South Africa'**, is not a requirement by law however, it appears to be SARS' approach to remuneration apportionment.

3.5.1 OECD Model Tax Convention's approach to sourcing of remuneration

According to the OECD online (2004), South Africa is not a member country of the OECD. South Africa was however, awarded OECD observer status in 2004 in its Committee on Fiscal Affairs (CFA), building on a dialogue with OECD countries on tax matters dating back to the early 1990s and covering key structural reforms in tax policy and administration (OECD online 2004).

The *OECD Model Tax Convention on Income and on Capital* (2008: 210, paragraph 1) states that the general rule to the taxation of income from employment (other than pensions), is that such income is taxable in the State where the employment is actually exercised. The general rule continues and states that employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid.

Therefore, it seems that that the remuneration sourcing principles followed by SARS seem to be in line with the OECD Model Tax Convention's approach since SARS' approach to

remuneration sourcing is to determine the location where the main/core (as opposed to casual and accidental, or subsidiary and incidental) services are rendered (SARS 2015: 10).

3.6 Sourcing of various forms/types of remuneration

This part of the research report will look at the various forms of remuneration namely, normal salary, benefits derived by reason of employment (commonly referred to as fringe benefits) and director's fees. The aforementioned types of remuneration will be analysed in the context of how they are taxed based on the income sourcing principles.

As discussed in part 3.2 of this research report, paragraph (*c*) of the definition of gross income brings into gross income of an expatriate any amount paid in respect of employment if it is from a South African source. Further, benefits derived by reason of employment (commonly referred to as fringe benefits) form part of an expatriate's gross income in terms of paragraph (*i*) of the definition of gross income if it is from a South African source.
As explained in the said part of this report (3.2), expatriates are taxable on South African sourced remuneration which forms part of their gross income which ultimately makes up their South African sourced taxable income (after taking into account the applicable exemptions and deductions).

In summary, any receipts or accruals from employment services (namely salary, bonus, income from employee share schemes, employee benefits and the like) which are from a South African source will be potentially taxable in the expatriate's hands.

The following are examples of remuneration items which may be payable to expatriates that the report is going to discuss in brief in the context of how they are taxed based on the principles as detailed in the relevant sections of the Income Tax Act (as indicated below) and the Seventh Schedule to the Income Tax Act:

- Salary and bonus (s 1 – gross income)
- Cash allowances (Seventh Schedule and s 8)
- The settlement of a debt on behalf of an employee by his or her employer or the release from a debt owed to the employer (Payment of an employee's debt - Seventh Schedule)
- Directors' fees (s 1 – gross income)

- Equity instruments acquired by virtue of employment i.e. shares or share equivalents acquired through an employee share scheme (s 8A and s 8C)
- Free or cheap residential accommodation (Seventh Schedule)
- The use of an employer-owned motor vehicle for private purposes (Seventh Schedule)

3.6.1 Salary and bonus

It is submitted that the remuneration sourcing principles as established in ITC 77 and also outlined in the SARS *Guide on the Taxation of Foreigners Working in South Africa* (2015:10) apply to salary and bonuses namely that source is to be found in the location where the services are rendered. If the core services were performed both in South Africa and outside of South Africa an apportionment would have to be made based on the formula discussed in part 3.5 of this report.

However, a point to note with regard to the payment of bonuses is that, bonuses are generally paid in future months following a specific performance period (post payment). Therefore, when determining the source of a bonus payment, the expatriate's location during the performance period needs to be considered as the originating cause for the bonus payment. Therefore, if the expatriate was outside South Africa during the performance period, the bonus will not be taxable in South Africa as it is not from a South Africa source and the reverse is true that is, if the expatriate was working in South Africa during the performance period, the bonus will be taxable in South Africa as it will be from a South African source.

3.6.2 Cash allowances

Section 8 provides as follows:

> '**Certain amounts to be included in income or taxable income** – (1) (a) (i) There shall be included in the taxable income of any person (hereinafter referred to as the "recipient") for any year of assessment any amount which has been paid or granted during that year by his or her principal as an allowance or advance, excluding any portion of any allowance or advance actually expended by that recipient—
>
> (aa) on travelling on business, as contemplated in paragraph (b), unless an allowance or advance has been granted by an employer in respect of the use of a motor vehicle as contemplated in paragraph 7 of the Seventh Schedule;
>
> (bb) on any accommodation, meals and other incidental costs, as contemplated in paragraph (c), while such recipient is by reason of the duties of his or her office or employment obliged to spend at least one night away from his or her usual place of residence in the Republic; …
>
> (ii) There shall not be included in the taxable income of a person in terms of the provisions of paragraph (a) (i), any amount paid or granted by a principal in reimbursement of, or as an advance for, any expenditure incurred or to be incurred by the recipient—

(aa) on the instruction of his or her principal in the furtherance of the trade of that principal; and
(bb) where that recipient must produce proof to that principal that such expenditure was wholly incurred as aforesaid and must account to that principal for that expenditure…'

SARS Income Tax Interpretation Note no 14 (2013:3) state that for the purposes of s 8(1) of the Income Tax Act,

'an allowance is an amount of money granted by an employer to an employee to incur business-related expenditure on behalf of the employer, without an obligation on the employee to prove or account for the business-related expenditure to the employer. The amount of the allowance is based on the anticipated business-related expenditure.'

The unspent portion of any allowance received is added to the expatriate's taxable income (SARS *Guide on the Taxation of Foreigners Working in South Africa* 2015:5).

SARS describes an advance as an amount of money granted by an employer to an employee to incur business-related expenses on behalf of the employer, with an obligation on the employee to prove or account for the business-related expenditure to the employer. The amount of the advance is based on the anticipated business-related expenditure. The employer recovers the difference from the employee if the actual expenses incurred are less than the advance granted and vice versa. (*SARS Income Tax Interpretation Note no 14* (2013:3).)

There will be no tax implications for the employee in receipt of an advance to incur business-related expenses on behalf of the employer, with an obligation on the employee to prove or account for the business-related expenditure to the employer (SARS 2013: 3). For example, there is no inclusion in gross income for the advance received and no deduction for the expenditure incurred (SARS *Guide on the Taxation of Foreigners Working in South Africa* 2015:9).

In terms of *SARS Income Tax Interpretation Note no 14* (2013:3) a reimbursement of business-related expenditure occurs when an employee has incurred and paid for business-related expenses on behalf of an employer without having had the benefit of an allowance or an advance, and is subsequently reimbursed for the exact expenditure by the employer after having proved and accounted for the expenditure to the employer.

'There will be no tax implications for an employee who is in receipt of a reimbursement. That is, no deduction for the expenditure incurred may be claimed by the employee and the employee is not required to include such reimbursement in his or her gross income' (SARS *Guide on the Taxation of Foreigners Working in South Africa* 2015:9).

Section 8(1)(a)(i) –

- deals with all allowances and advances paid by a 'principal' to a 'recipient' (for example, travel, subsistence, public office, cell phone and housing allowances); and
- provides that all such allowances and advances must be included in the recipient's taxable income to the extent that it was not expended as specified in section 8(1) (SARS 2013: 5).

Section 8(1) only permits a deduction for expenditure incurred in relation to travelling on business, expenditure incurred for accommodation, meals and incidental costs while an office holder or employee is obliged to spend at least one night away from his or her usual place of residence as a result of business. (*SARS Income Tax Interpretation Note no 14* (2013:22).)

De Koker and Williams (2017: 20-3) state that:

> 'Any allowance or advance that is included in gross or taxable income by s 8(1) is 'remuneration' and is subject to the deduction of employees' tax…On the other hand, amounts excluded by s 8(1) do not constitute 'remuneration' and are not subject to the deduction of employees' tax.'

Otherwise all other allowances are fully taxable (Haupt 2017:364).

It is submitted that remuneration sourcing principles as established in ITC 77 and also outlined in the SARS *Guide on the Taxation of Foreigners Working in South Africa* (2015:10) apply to cash allowances namely that source is to be found in the location where the services are rendered. If the core services were performed both in South Africa and outside of South Africa an apportionment would have to be made based on the formula discussed in part 3.5 of this report.

3.6.3 Payment of an employee's debt

In terms of para 2*(h)* of the Seventh Schedule to the Income Tax Act a taxable benefit arises in the hands of an expatriate when the employer settles the expatriate's debt to a third party, whether directly or indirectly, without requiring that expatriate to make any payment for the amount paid by the employer for example children's school fees, club membership fees, payment of home leave flights and other similar benefits. One other example of a benefit which an employer may provide to an expatriate is a release of the expatriate from an obligation to pay an amount owing by that expatriate to the tax authorities. This benefit is commonly referred to as a tax equalization benefit or it may also take the form of a tax protection benefit.

The value of the benefit in the expatriate's hands is the amount paid by the employer or the amount of the debt from which the expatriate has been released (SARS *Guide on the Taxation of Foreigners Working in South Africa* 2015:19 and 41).

SARS (2015: 19) states that:

> 'Certain employers contractually agree to settle an employee's tax liability whilst that employee is on secondment in a foreign country. The objective is to ensure that the seconded employee remains tax-neutral and is in no worse a position than if the secondment had not been accepted. This practice, which encourages employees to accept secondment assignments in foreign countries, is known as tax equalization.'

In the event where an employer contractually agrees to settle an expatriate's income tax liability (enter into a tax equalization contract) SARS accepts the use of a gross-up formula to determine the fringe benefit which arises in this instance (SARS 2015: 19).
Employers may adopt various forms of tax equalization policies which may create challenges and uncertainty for SARS as the concept of tax equalization is not legislated. However, this research report will not discuss these challenges.

It is submitted that remuneration sourcing principles as established in ITC 77 and also outlined in the SARS *Guide on the Taxation of Foreigners Working in South Africa* (2015:10) apply to the payment of an employee's debt namely that source is to be found in the location where the services are rendered. If the core services were performed both in South Africa and outside of South Africa an apportionment would have to be made based on the formula discussed in part 3.5 of this report.

3.6.4 Directors' fees

Directors' fees are merely an example of amounts received or accrued for the rendering of services. The principles which determine the source of directors' fees, however, deviate from those applicable to the rendering of services in general as a result of the imposition of a legal fiction. Thus, it has been held that a director's services in his capacity as such are, as a matter of common law, deemed to be rendered at the head office of the company where the board of directors ordinarily transacts its business. (De Koker and Williams (2017: 5-19).)

Consequently, if the head office is in the Republic, the fees are derived from a South African source, irrespective of the place where the director resides and performs the services (De Koker and Williams 2017: 5-19).
De Koker and Williams (2017: 5-19) are of the view that a director who is ordinarily resident outside the Republic would therefore be liable to South African tax on his fees if the board of directors meets in the Republic.

The sourcing principles as discussed above are applicable to non-executive director as described in the King III report (2009: 53) as the non-executive directors do not exercise executive authority in the day to day management of a company.

The King III report as issued by The Institute of Directors in Southern Africa and The King Committee (2009: 53) provides the following as the crucial elements of a non-executive director's role –

- must provide objective judgment independent of management of a company;
- must not be involved in the management of the company; and
- is independent of management on issues such as, amongst others, strategy, performance, sustainability, resources, diversity…

De Koker and Williams (2017: 5-19) state that a director may also render services for his company in a capacity other than that of director, for example, he may be appointed to manage the day-to-day affairs of a company or he may assist in the buying or selling operations of the company on a full-time basis. The source of the remuneration of a director who holds a salaried appointment must, it is submitted, be determined in accordance with the general remuneration sourcing principles set out in part 3.4 above. The King III report (2009: 53) describes an executive director's role as one who has an involvement in the day-to-day management of the company or being in the full-time salaried employment of the company (or its subsidiary) or both.

3.6.5 Equity instruments acquired by virtue of employment

Any gains or losses made by a foreigner on the vesting of equity instruments (essentially shares and options) which were acquired by the foreigner on or after 26 October 2004 by virtue of employment or the holding of the office of director, and which are attributable to a South African source, are subject to income tax in South Africa (SARS 2015:25).

De Koker and Williams (2017: 20-31) state that particular provisions apply where the remuneration of an employee includes any gain made in respect of share incentive plans as envisaged in s 8A (a right obtained before 26 October 2004) and any taxable amount in respect of the vesting of equity instruments in terms of s 8C of the Income Tax Act.
The provisions in relation to employee share schemes are discussed in further detail in part 3.7.1 of this report.

It is submitted that remuneration sourcing principles as established in ITC 77 and also outlined in the SARS *Guide on the Taxation of Foreigners Working in South Africa* (2015:10) apply to the remuneration from employee share incentive schemes namely that source is to be found in the location where the services are rendered. If the core services were performed both in South Africa and outside of South Africa an apportionment would have to be made based on the formula discussed in part 3.7.1 of this report.

3.6.6 Free or cheap residential accommodation

Para 2*(d)* of the Seventh Schedule to the Income Tax Act states that residential accommodation provided to an employee free of charge or at a discount is taxable in the hands of the employee subject to the provisions of para 9 of the Seventh Schedule to the Income Tax Act .

Paras 9(7) of the Seventh Schedule to the Income Tax Act states that no value is placed on the accommodation (in other words, no tax implications arise) provided by the employer to an employee while the employee is away from his or her usual place of residence in South Africa for the purposes of performing the duties of his/her employment.

Paras 9(7A) of the Seventh Schedule to the Income Tax Act states that no value is placed on the accommodation (in other words, no tax implications arise) provided by the employer to an employee (this would also apply to expatriates) **while the employee is away from his or her usual place of residence outside South Africa** (emphasis added) –

- for a period not exceeding two years from the date of arrival of that expatriate in South Africa, for the purposes of performing the duties of his or her employment; or
- if the accommodation is provided to that expatriate during the year of assessment and that employee is physically present in South Africa for a period of less than 90 days in that year.

Further, according to para 9(7B) of the Seventh Schedule to the Income Tax Act the exclusions found in paras 9(7) and 9(7A) of the Seventh Schedule to the Income Tax Act do not apply –

- if the expatriate was present in South Africa for longer than 90 days during the year of assessment immediately preceding the date of arrival referred to above; or
- to the extent that the cash equivalent of the value of the taxable benefit derived from the occupation of the residential accommodation exceeds an amount equal to R25 000 per month during which the benefit is granted. Thus, if the rental value is less than R25 000, no value is placed on the accommodation provided. To the extent that the rental value is greater than R25 000, the excess is taxable.

The above provisions contained in para 9(7) of the Seventh Schedule to the Income Tax Act specifically the interpretation of 'usual place of residence' was addressed in ITC 1807(2006) 68 SATC 154. Waglay J on page 161 of the judgement held that:

> 'the notion of "ordinary residence" had been held to equal the notion of a taxpayer's 'usual or principal residence…
>
> I would respectfully adopt the formulation of Schreiner JA and hold that a person is 'ordinarily resident' where he has his usual or principle residence, i.e. what may be described as his real home…
>
> Flowing from both Cohen and Kuttel matters, a person's 'usual place of residence', as contemplated in para 9(7) of the Seventh Schedule of the Act, is the place where he or she would naturally and as a matter of course return from his or her wanderings, and it would be described more aptly than other places as his/her real home. A person's usual place of residence is synonymous with his/her 'ordinary residence.'

Therefore, in order for an expatriate to qualify for the tax exclusions afforded by the provisions contained in para 9(7A) of the Seventh Schedule to the Income Tax Act, the expatriate should not be ordinarily resident in South Africa at the start of the assignment/secondment and the intention should be to stay in South Africa temporarily. However, should the expatriate's intention change and they decide to stay in South Africa permanently or consider South Africa to be their 'real home', it is submitted that the tax exclusion will not apply and the accommodation benefit will be taxable in full as the expatriate's usual place of residence would have changed to South Africa.

It is submitted that the above provisions apply to a benefit provided by an employer to an expatriate which is the right to occupy accommodation and does not apply to a

rental/accommodation allowance which would be taxable as a cash allowance as discussed in part 3.6.2 of this report.

SARS' stated approach to remuneration apportionment (SARS 2015:11) is that **if the taxable benefit is received for exclusive use in South Africa** it will not be subject to apportionment Therefore, in accordance with the statement in the preceding sentence (SARS 2015:11), it appears that SARS will not apportion the accommodation benefit. This approach is contrary to the normal remuneration sourcing principles (as discussed in part 3.4 of this research report). This approach however, is not a requirement by law, it appears to be SARS' approach to remuneration apportionment and it may be challenged by an aggrieved taxpayer under sections101 to 150 of the Tax Administration Act.

The question on the apportionment of the accommodation becomes relevant in instances where the accommodation benefit is taxable and will not be relevant where the benefit is fully excluded from tax.

Further, in calculating the accommodation benefit under para 9 of the Seventh Schedule to the Income Tax Act, the Income Tax Act prescribes the use of a formula found in subparagraph (3) of the said para 9. The said formula in subparagraph (3) of para 9 of the Seventh Schedule to the Income Tax Act makes provision for the number of months which the expatriate was entitled to that accommodation. Various readers or taxpayers may interpret this part of the formula to mean that even if the accommodation itself is not occupied by the expatriate the fact that it was still available for his/her use, the formula for the calculation of the benefit does not provide for apportionment where the expatriate was out of South Africa working in a foreign country.

3.6.7 The use of an employer-owned motor vehicle for private purposes

Para 2*(b)* of the Seventh Schedule to the Income Tax Act states that a taxable benefit arises when an employer has granted an employee the right of use of a motor vehicle for private or domestic purposes and such use has been granted free of charge or for a consideration payable by the employee which is less than the value of the private or domestic use.

For a taxable benefit to arise the employee must have been given the right to use the company car for private or domestic purposes. The absence of such private use means a taxable benefit

does not arise. Private use includes, amongst others, travelling between the employee's home and his or her place of employment. (SARS (2015: 14).)

The cash equivalent of the value of the taxable benefit, which is included in the employee's gross income, is equal to the value of private use less any consideration given by the employee to the employer for private use (para 7(2)) of the Seventh Schedule to the Income Tax Act.

SARS' stated approach to remuneration apportionment (SARS 2015:11) is that **if the taxable benefit is received for exclusive use in South Africa'** it will not be subject to apportionment. Therefore, in accordance with the statement in the preceding sentence (SARS 2015:11), it appears that SARS will not apportion the benefit arising from the right of use of a company owned/provided motor vehicle. This approach is contrary to the normal remuneration sourcing principles (as discussed in part 3.4 of this research report). This approach however, is not a requirement by law however, it appears to be SARS' approach to remuneration apportionment and it may be challenged by an aggrieved taxpayer under provisions 101 to 150 of the Tax Administration Act.

More significantly, para 7(5) of the Seventh Schedule to the Income Tax Act provides that –

> No reduction in the value determined under subparagraph (4) shall be made for the purposes of item (b) of that subparagraph by **reason of the fact that the vehicle in question was during any period for any reason temporarily not used by the employee for private purposes**.

Stated more clearly, the discussion in the preceding paragraph means:

> 'if the employee (expatriate) is only entitled to use the motor vehicle for a part of a month, the value of the private use is apportioned on a daily basis, but no reduction is made simply because the vehicle is for any reason temporarily not used by the employee (expatriate)', Stiglingh et al (2017: 376).

3.6.8 Practical implications and approach to the apportionment of remuneration

In SARS (2015:11) it is stated that:

> 'all amounts received in respect of employment **may qualify for apportionment**, including cash, allowances and taxable benefits granted in respect of the employee's employment, **unless the taxable benefit is received for exclusive use in South Africa**' (emphasis added).

The preceding statement suggests that an expatriate who meets the criteria for remuneration apportionment (as discussed in parts 3.5 and 3.6 of this research report), may not be allowed to apportion certain types of remuneration if the remuneration is for exclusive use in South Africa.

It is submitted that in practice taxpayers and/or tax practitioners are likely to have differing interpretations of what the statement in the first paragraph of subsection 3.6.8 means:

(i) if for example, an expatriate receives a cash allowance or benefit such as children's school fees, club membership fees (for a South African club), spousal allowance (accompanying spouse not allowed to work in South Africa), daily allowance/per diem, accommodation allowance, there could be a view that the expatriate received these allowances and/or benefits for exclusive use/enjoyment in South Africa therefore, these benefits are not subject to apportionment.

(ii) Another view could be that all cash allowances (regardless of the form/type or reason of allowance) may be subject to apportionment as the expatriate may expend the money in whichever country he/she is however, the benefits which are enjoyed in South Africa such as children's school fees (if the children are based in a South African school), club membership fees, right of use of company car and accommodation (where the expatriate rents or buys a house in South Africa) should not be apportioned as they are for exclusive use/enjoyment in South Africa.

The two differing views/interpretations highlighted above may result in the provisions of the Income Tax Act being susceptible to abuse and/or undesirable aggressive tax planning (in SARS's view) in the drafting of employment/secondment contracts and may result in employees of the same company being treated differently for tax purposes depending on whether they receive a cash allowance or a fringe benefit. This may not necessarily be a bad scenario for an expatriate as they may save on the taxes payable in South Africa through remuneration apportionment however, it may be harmful to SARS' efforts of trying to collect taxes from income arising from a South African source as the tax base or amount of taxable income may diminish due to remuneration apportionment. For an example an employee may request that he be paid an allowance for children's school fees instead of receiving a benefit paid directly by his employer to a third party and in that way he/she may take advantage of the remuneration apportionment provisions.

Finally and most important is that this statement by SARS (2015:11)

> 'all amounts received in respect of employment may qualify for apportionment, including cash, allowances and taxable benefits granted in respect of the employee's employment, unless the taxable benefit is received for exclusive use in South Africa'

seems to deviate from the basic principle of remuneration sourcing (discussed in part 3.4 of this research report) which states that the source of remuneration is where the services are physically rendered.

3.7 Employees' tax / Pay As You Earn (PAYE) obligations for the employer and the change in the definition of a provisional taxpayer

Every employer who is a resident – or representative employer in the case of a non-resident employer – who pays or becomes liable to pay an amount of remuneration to an employee must deduct or withhold the appropriate amount of employees' tax, unless the Commissioner has granted authority to the contrary (De Koker and Williams 2017: 20-58). De Koker and Williams (2017: 20-58) also note that it does not matter whether or not he is registered as an employer. Stiglingh et al (2017: 431) explain that the words 'liable to pay' indicates a contractual liability to incur the amount. Stiglingh et al (2017: 431) conclude that the employee must therefore have an enforceable right to the amount of remuneration.

Haupt (2017: 231) states that the employees' tax so withheld is determined by reference to tables issued by SARS. Haupt (2017:231) also states that the tax withheld is sometimes referred to as PAYE (Pay as You Earn).
The amount so deducted or withheld must be paid to the Commissioner for SARS within seven days after the end of the month during which it was deducted or withheld (De Koker and Williams 2017: 20-58).
A person who willfully and without just cause makes or becomes liable to make a payment of remuneration and fails to deduct or withhold from it an amount of employees' tax or to pay such an amount to the Commissioner in the manner required by para 2 of the Fourth Schedule to the Income Tax Act will be guilty of an offence and liable on conviction to a fine, to imprisonment for a period not exceeding twelve months or to both the fine and imprisonment (De Koker and Williams 2017: 20-59).

This means where an expatriate receives remuneration from a South African resident employer, the employer has an obligation to withhold employees' tax from such remuneration and pay it over to SARS in the prescribed manner as provided for in para 2 of the Fourth Schedule to the Income Tax Act.

The employees' tax provisions discussed above apply in the event where an expatriate receives remuneration from a South African resident employer. This essentially implies that expatriates who receive remuneration from an employer who is not resident in South Africa will not be subject to employees' tax in South Africa. For instance, expatriates who remain on their home country or foreign payrolls are not subject to South African employees' tax withholding provided they do not receive any remuneration elements or benefits from a South African resident employer. However, there is one situation where the Income Tax Act imposes employees' tax withholding on foreign paid remuneration and this applies to remuneration received through the participation of an expatriate in an employee share incentive scheme (equity instrument acquired by virtue of employment). Further details on employees' tax withholding is covered in part 3.7.1 below.

In the event that an expatriate is paid by a non-resident employer, receives no benefits from a South African resident employer and does not participate in an employee share incentive scheme, that expatriate's remuneration will not liable to employees' tax withholding in South Africa. This essentially means that an expatriate who falls within this scenario and who receives remuneration from a source in South Africa will be liable to settle his/her South Africa income tax liability post submission of his/her annual tax return once an assessment has been issued in terms of s 25, 96 and 162 of the Tax Administration Act.

In order to regulate the situation where expatriates are not subjected to employees' tax, the legislation was amended in order to broaden the definition of a provisional taxpayer to mean (effective 1 March 2017):

(a) 'any person (other than a company) who derives income by way of—

(i) any remuneration from an employer that is not registered in terms of paragraph 15; or

(ii) any amount which does not constitute remuneration or an allowance or advance contemplated in section 8 (1);…'

De Koker and Williams (2017: 21-1) state that provisional taxpayers are required to make and may volunteer advance payments, known as provisional tax payments, on account of their estimated liability for normal tax for a particular year of assessment.
Therefore, effective 1 March 2017, expatriates who are paid by an employer who is not resident in South Africa are required to register as provisional taxpayers and submit

provisional tax returns together with the corresponding tax payments as provided for in paras 1, 17, 19 and 21 of the Fourth Schedule to the Income Tax Act.

It is submitted that the change in the definition of a provisional taxpayer, which now includes expatriates who are paid by an employer who is not resident in South Africa, will assist SARS reduce the risk of non-payment of the South African tax due by expatriates by compelling expatriates to make advance tax payments in the form of provisional tax payments rather than making payment on assessment after the submission of a tax return.

3.7.1 Share incentive schemes (Equity instrument acquired by virtue of employment) and the related employees' tax withholding

De Koker and Williams (2017:20-31) state that gains from employee share incentive schemes are included in the remuneration of an employee by virtue of paras (*b*), and (*e*) of the definition of the term 'remuneration' respectively as found in the Fourth Schedule to the Income Tax Act.

For the purposes of the Fourth Schedule, the amount of the gain or remuneration arising out of the right to participate in an employee share incentive scheme is deemed to be an amount of remuneration payable to the employee by the person by whom the right was granted or from whom the qualifying equity share or equity instrument was acquired (De Koker and Williams 2017:20-32).

According to the *SARS Binding Class Ruling number 25* (2011:3) expatriates who are participants in an employee share incentive/scheme will be subject to normal tax in South Africa on South African source income, which will include any gain under s 8A and s 8C of the Income Tax Act. SARS (2011:3) states that the income which is attributable to a South African source will be deemed to have accrued or received evenly over the period if the source of the income from employee share incentive scheme is in relation to work performed inside and outside South Africa. The South African sourced income from employee share incentive scheme is determined upon the number of days which an expatriate spent in South Africa between the grant date to exercise date (in terms of s 8A of the Income Tax Act) or the grant date to vesting date (in terms of s 8C of the Income Tax Act).

SARS (2011:3) illustrates the apportionment of source from employee share incentive schemes (the deemed South African source) by way of the following formula:

(i) cases to which the provisions of s 8A apply:

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of vesting}} \times \text{Section 8C gain}$$

Or

(ii) cases to which the provisions of s 8C apply:

$$\frac{\text{Total calendar days in South Africa}}{\text{Total calendar days between date of grant and date of exercise}} \times \text{Section 8A gain}$$

= The portion of the gain that will be deemed to be from a South African source and taxable in South Africa during the year of assessment in which a s 8A or s 8C event takes place

However, the apportionment formula as discussed in part 3.5 of this research report (as contained in SARS 2015:10) bases the apportionment on 'work days' and this formula for apportioning remuneration from employee share incentive schemes (in part 3.7.1) is based on 'calendar days' even though the apportionment principle is the same.
The difference in the use of work days and calendar days on remuneration apportionment is confirmation of how the lack of apportionment provisions in the Income Tax Act may result in SARS applying different approaches to remuneration sourcing.

Employees' tax withholding on employees share incentive schemes

As noted in part 3.7 above, employees' tax withholding is generally an obligation imposed by the Income Tax Act on South African resident employers (or representative employers) who have an obligation to pay remuneration. However, there is an exception to this general rule in relation to remuneration received or accrued from employee share incentive schemes under para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act.

With reference to the employer/entity which has granted the employee/expatriate with participatory rights to the employee share incentive scheme, Para 11A(1) of the Fourth Schedule to the Income Tax Act provides that this is the person who is liable to pay the remuneration with reference to an equity instrument acquired by virtue of employment.

Further, Para 11A(2)(a) of the Fourth Schedule to the Income Tax Act provides that the person (employer) identified in Para 11A(1) has the obligation to withhold and pay over employees' tax to SARS in the manner prescribed in the relevant provisions of the Fourth Schedule to the Income Tax Act as discussed in part 3.7 above. Para 11A(2)(b) of the Fourth Schedule to the Income Tax Act provides that if the person/employer identified in para 11A(1) of the Fourth Schedule to the Income Tax Act is not resident in South Africa but, this person is an 'associated institution' as defined in para 1 of the Seventh Schedule to the Income Tax Act to a South African resident employer, the non-resident employer together with the South African resident employer will be jointly and severally liable to withhold the employees' tax on the remuneration paid with reference to an equity instrument acquired by virtue of employment.

The preceding paragraph essentially means that if the non-resident employer granting the participatory rights to the employee share incentive scheme is in the same group of companies or has the same management as a South African resident employer, both employers (the resident and non-resident) will be held liable by SARS for the withholding of employees' tax from the gain realized by an employee in relation to remuneration received or accrued with reference to an equity instrument acquired by virtue of employment (Para 11A(2)(b) of the Fourth Schedule to the Income Tax Act).

The provisions of para 11A(1) and 11A(2)(b) of the Fourth Schedule to the Income Tax Act appear to be outside of the ambit of para 2 (which is the employees' tax charging provision) as the liability to withhold employees' tax in terms of para 2(1) of the Fourth Schedule to the Income Tax Act is assigned to a South African resident employer or a representative employer and this does not include an associated institution as defined in the Seventh Schedule to the Income Tax Act. Since the Commissioner for SARS has limited legal authority over a non-resident employer, in the event of a default on the withholding obligation placed on the South African non-resident employer, with regard to remuneration received or accrued with reference to an equity instrument acquired by virtue of employment (in terms of 11A(1) and 11A(2)(b) of the Fourth Schedule to the Income Tax Act), there is little recourse for SARS in order to recover the employees' tax which may not have been withheld. It is submitted SARS stands a better chance of recovering the amounts from the South African resident employer/representative employer which is an associated institution to the non-resident employer.

In an attempt to understand why the legislators would have made this seemingly odd withholding provision (11A(1) and 11A(2)(b) of the Fourth Schedule to the Income Tax Act), it is submitted that it is common for the employee share incentive schemes to be administered outside of South Africa on behalf of South African resident employers therefore, in order to enforce employees' tax withholding compliance the legislators may have found it fitting to bring the non-resident employer/associated institution to the South African tax net by imposing a employees' tax withholding obligation upon them.

3.8 End of chapter summary

If an expatriate is in receipt of South African sourced gross income, that expatriate will be liable for income tax on the taxable income resulting from the South African sourced gross income.

Haupt (2017:43) states that it is an established principle that the source of income from services rendered is located where the services are rendered. Haupt further states that (2017:43) the 'originating cause' (as established in *CIR v Lever Brothers and Unilever Ltd* case) is the rendering of the services which is the quid pro quo in respect of which the income is received. The source of the income is not dependent on where the service contract is signed or where the payment is made (Haupt 2017: 43).

SARS' approach to remuneration sourcing is stated as follows (SARS 2015:10) –

> 'the correct test of source for employment income is to determine what services the employee was engaged to perform, and then to determine the location where those services were required to be rendered.'

SARS (2015:5) concurs that the remuneration received by an expatriate for services rendered inside and outside South Africa could be apportioned based on the number of days worked in and outside of South Africa during a year of assessment.

As outlined in parts 3.5, 3.6 and 3.7.1 of this research report SARS applies various approaches to remuneration apportionment depending on the form/type of remuneration. Further, SARS adopts the use of both work days and calendar days for remuneration apportionment basis although ultimately the apportionment principle is the same.

It is submitted that the discussions in chapter 2 and 3 of this report suggest that it may be more favorable (where the expatriate's country of tax residence has a lower tax rate than South Africa), for expatriates who are working or assigned to South Africa on a short term

assignment, to remain non-resident in South Africa for at least the first five years of assessment (following his/her physical arrival in South Africa). The reason why the status of being non-resident in South African seems favorable is because, unlike a resident who is subject to tax in South Africa on his/her worldwide income, a non-resident may have a lower tax base in South Africa as he/she will be taxable in South Africa on South African sourced income in terms of the gross income definition in s 1(1) of the Income Tax Act.
An expatriate may qualify for remuneration apportionment which means a certain percentage of his/her remuneration will not be subject to South African tax. An expatriate is only subject to capital gains tax in South Africa on the disposal of immovable property situated in South Africa or certain interests in immovable property situated in South Africa which means any capital gains that he/she realizes on the disposal of South African movable property (provided that the capital gain is not in relation to an interest in immovable property situated in South Africa) will not be subject capital gains tax in terms of paras 2(*b*), 3 and 4 of the Eighth Schedule to the Income Tax Act.

SARS' statement that (SARS 2015:11)

> 'all amounts received in respect of employment may qualify for apportionment, including cash, allowances and taxable benefits granted in respect of the employee's employment, unless the taxable benefit is received for exclusive use in South Africa'

may result in various interpretations and seems to deviate from the established remuneration sourcing principle. The fundamental principle of remuneration sourcing (discussed in part 3.4 of this research report) states that the source of remuneration is where the services are physically rendered. The reason why SARS' remuneration apportionment approach deviates from the fundamental principle of remuneration sourcing is because SARS' statement refers to where the benefit is used instead of considering the location of the employment services to determine the source of the remuneration.

Expatriates who are employed and paid by a resident employer will be subjected to employees' tax withholding therefore, they will receive their remuneration net of tax.

Effective 1 March 2017 expatriates paid by a non-resident employer are required to register as provisional taxpayers in terms of the definition of a provisional taxpayer under para 1 of the Fourth Schedule to the Income Tax Act.
It is submitted that the change in the definition of a provisional taxpayer, which now includes expatriates who are paid by an employer who is not resident in South Africa, will assist

SARS reduce the risk of non-payment of the South African tax due by expatriates by compelling expatriates to make advance tax payments in the form of provisional tax payments rather than making payment on assessment after the submission of a tax return.

Provisional tax is an advance payment of normal tax, made in instalments during the year (Haupt 2017:231).
Provisional is a method of tax collection to ensure better cash flow for SARS and to facilitate the collection of taxes by compelling taxpayers to make advance tax payments (Stiglingh et al (2017: 470).

4. What are the underlying problems with the current income tax provisions?

4.1 Introduction

Adam Smith's four maxims of a good tax system (1776: 818) may be summarized as follows:

I. ' The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate.'

This maxim consists of what is called the equality or inequality of taxation (Smith 1776:818). In other words, this maxim states that every person should pay depending on their ability to pay which means that the taxes which a person pays should be proportionate to the income they have received or accrued.

It is submitted that the South African tax system incorporates the above maxim in its current tax principles since, in the case of individuals, the annual tax liability is calculated on a sliding scale as published by the Minister of Finance from time to time in terms of s 5(1) and s 5(2) of the Income Tax Act. The current tax rates applicable to individuals are from 18% to 41% depending on their level of taxable income (Haupt 2017:8). However, effective from 1 March 2017 the maximum tax rate for individuals has increased from 41% to 45%.

II. 'The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.'

It is submitted that the South African tax system incorporates this maxim in its current tax principles as evidenced by s 5(2) of the Income Tax Act which states that:

'(a) The Minister may announce in the national annual budget contemplated in section 27 (1) of the Public Finance Management Act 1999, (Act No. 1 of 1999), that, with effect from a date or dates mentioned in that announcement, the rates of tax chargeable in respect of taxable income will be altered to the extent mentioned in the announcement.

(b) If the Minister makes an announcement of an alteration contemplated in paragraph (a), that alteration comes into effect on the date or dates determined by the Minister in that announcement and continues to apply for a period of 12 months from that date subject to Parliament passing legislation giving effect to that announcement within that period of 12 months.'

The above provisions of the Income Tax Act outline the rates applicable to a taxpayer. The announcement is usually made prior to the commencement of a year of assessment which means that taxpayers are given notification upfront of how much taxes they may be liable to pay in the new year of assessment. This creates a level of certainty in terms of the tax amount which may be payable by an individual for the year of assessment.

The provisions of s 162 of the Tax Administration Act comply with the second requirement of the above maxim (the time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person). The provisions of s 162 read as follows:

> '**Determination of time and manner of payment of tax**.—(1) Tax must be paid by the day and at the place notified by SARS, the Commissioner by public notice or as specified in a tax Act, and must be paid as a single amount or in terms of an instalment payment agreement under section 167.
>
> (2) The Commissioner may by public notice prescribe the method of payment of tax, including electronically.'

The provisions of s 162 of the Tax Administration Act afford clear communication of the Commissioner's intention to provide clarity and certainty on the time and manner of payment of tax.

III. 'Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it…'

Smith (1776:819) states the following in elaboration to the third maxim of taxation:

> 'A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay; or, when he is most likely to have wherewithal to pay.'

The above extract illustrates that the timing and method of tax payment should be convenient for the taxpayer. The above extract further explains that tax needs to be paid when it is very much likely that the taxpayer will be in a good position to pay the tax.

It is submitted that the definition of gross income in s 1(1) of the Income Tax Act is an example of how the South African tax system incorporates the third maxim of a good tax system. In terms of the definition of gross income in s 1(1) of the Income Tax Act, an individual will be taxed on the receipt or accrual of an amount. This, by implication, means that there can be no tax payable if the amount has not been received nor accrued.

IV. ‘Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.’

The fourth maxim of a good tax system determines that the cost of collecting taxes should be significantly low in comparison to the tax collected. For example if the cost, time and effort expended by a tax authority (SARS) to collect the amount of tax is more than the actual taxes collected then it means that tax system is a poor system since it costs the tax authorities more money to collect the tax than the actual amount that it receives (negative return on investment).

In addressing the requirements of the fourth maxim of a good tax system, in South Africa tax is collected by means of various withholding taxes (like employees’ tax), provisional tax (which is paid six-monthly with a third voluntary top-up payment which needs to be made less than six months after the end of the year of assessment in order not to attract interest for late payment or seven months where the taxpayer’s year of assessment ends at the end February), with the balance of the tax for the year being due when assessment is issued (Haupt 2017:230).
Section 179 of the Tax Administration Act authorizes SARS to appoint third parties to collect tax on SARS’ behalf in the event where the normal tax collection methods have been applied and the tax debt remains unpaid. In terms of s 179 of the Tax Administration Act third party appointment may happen under the following circumstances:

> ‘(1) A senior SARS official may authorise the issue of a notice to a person who holds or owes or will hold or owe any money, including a pension, salary, wage or other remuneration, for or to a taxpayer, requiring the person to pay the money to SARS in satisfaction of the taxpayer’s outstanding tax debt…
> (3) A person receiving the notice must pay the money in accordance with the notice and, if the person parts with the money contrary to the notice, the person is personally liable for the money.
> (4) SARS may, on request by a person affected by the notice, amend the notice to extend the period over which the amount must be paid to SARS, to allow the taxpayer to pay the basic living expenses of the taxpayer and his or her dependents…’

The provisions of s 179 of the Tax Administration Act are one of the examples which demonstrate how the South African tax system is structured to make tax collection easy, cost effective and convenient. This is achieved by appointing a third party who holds or owes money to the indebted taxpayer and that appointed third party will in all probability be required to make payment to the indebted taxpayer. This makes the tax collection easier to manage and convenient in that the collection of the tax debt (the actual amount owed/to be

collected) may be adjusted so that the taxpayer is still able to pay for his/her daily living expenses in terms of s 179 (4) of the Tax Administration Act.

Sections 225 to 233 of the Tax Administration Act encourages taxpayers to be tax compliant by affording taxpayers relief from certain tax penalties in the event that taxpayer s come forward voluntarily in the event where there has been non-compliance (voluntary disclosure) and imposes various penalties and even imprisonment in the event on non-compliance in terms of ss 208 to 224 and ss 234 to 238 of the Tax Administration Act respectively.

It is the author's view that s 169(4) of the Tax Administration Act is a notable provision which validates the intentions of the legislators to keep the cost of tax collection low. Section 169(4) of the Tax Administration Act reads as follows:

> 'SARS need not recover a tax debt under this Chapter if the amount thereof is less than R100 or any other amount that the Commissioner may determine by public notice, but the amount must be carried forward in the relevant taxpayer account.'

The preceding excerpt from the Tax Administration Act suggest that a debt of R100 is an inconsiderable amount therefore, it is submitted that national treasury is of the view that it would be a waste of resources to apply efforts to collect this amount of money.

Notwithstanding the South African tax system's best efforts to align itself to the maxims of a good tax system (established by Adam Smith) as noted above, there is still room for improvement with regard to the current legislative provisions in relation to the taxation of expatriates as discussed below.

4.2 The underlying problems with the current income tax provisions

This research report focuses on the following topics which have been identified as problematic in their current state:

(1) Remuneration apportionment
(2) The provisional tax method of tax collection for expatriates not reported on a South African payroll
(3) Employees' tax withholding on employee share incentive schemes
(4) Application of a Double Tax Agreement
    (a) Expatriates working in South Africa for less than 183 days

(b) Economic employer principle

4.2.1 Remuneration apportionment

According to De Koker and Williams (2017: 5-24-1) there is no general provision in the Act that provides for a deemed source in relation to amounts derived from employment or for services rendered. There is, however, a specific deemed-source provision (s 9(2)(g) and (h) of the Income Tax Act) with regard to services rendered by a holder of a public office (to which that person has been appointed or is deemed to have been appointed in terms of an Act of Parliament) or for an employer in the national, provincial or local sphere, a constitutional institution, a public entity or a municipal entity (De Koker and Williams 2017: 5-24-1).
It is submitted that these deemed source provisions are also applicable to expatriates who work for the South African government as specified above.

Stiglingh et al (2017: 73) notes that difficulties may arise in locating the source of income if the activities that result in the income being received are performed in South Africa and in one or more other countries. They continue to state that (2017: 73) in the circumstances the whole or part or no part of the receipt might be regarded as constituting income from a source within South Africa. In addition, these authors confirm that (2017: 73) the courts have discussed the problem (apportionment of source) but have not yet been called upon to solve it. In ITC 77 (1927: 73) the courts have however indicated that the apportionment of source is possible where an employee is contracted to perform their core services both in and outside of South Africa.

According to the *CIR v Lever Brothers and Unilever Ltd* case (1946: 8) (discussed in part 3.3 of this research report), in determining the source of income, the originating cause of the income must first be established and then the location of the originating cause must be determined.
It is submitted that, if the *Unilever* principle is applied that if the location of the originating cause is found to be inside and outside South Africa, then the source of income should be apportioned between South African and non-South African source.

In ITC 77 (1927: 73) (discussed in part 3.4 of this research report), it was established that in the application of the source tests, regard must be had to the contract of employment in order to ascertain whether the employee has contracted to render services both within and outside the Republic. If he has so contracted, the remuneration relating to the services rendered

outside the Republic would not be from a South African source (ITC 77 1927: 73). But if he has not contracted to render services outside the Republic, the full remuneration must be from a Republic source, even though occasional or casual services are performed outside the Republic (ITC 77 1927: 75).

Under the South African Income Tax Act as presently constituted, there are no provisions for the apportionment of a source of income Stiglingh et al (2017: 73).

Therefore, it is submitted that the absence of general sourcing provisions in relation to remuneration or the absence of provisions for the apportionment of a source of income, as highlighted by De Koker and Williams above, is a fundamental problem for both the expatriates and SARS.

In essence the absence of general remuneration sourcing provisions from the Income Tax Act results in the contentious remuneration apportionment/sourcing issues discussed in part 3.6 above (for example the issues discussed in respect of the use of an employer-owned motor vehicle for private purposes and free or cheap residential accommodation). The issue with regard to both these benefits is that the provisions of the Seventh Schedule to the Income Tax Act with relation to the calculation of the taxable benefit from the use of a company car and the provision of residential accommodation do not provide for apportionment where the expatriate was out of South Africa working in a foreign country.

The said absence of the general remuneration sourcing provisions from the Income Tax Act allows for numerous interpretations which creates uncertainty for both SARS and the expatriates and is susceptible to abuse (from a SARS perspective). An example of the aforementioned abuse could be in the form of expatriates opting for a cash allowance rather than obtaining say, a benefit for children's school fees (which would be paid directly to a vendor/supplier) due to the potential tax treatment thereof namely, that the cash allowance may be subject to apportionment between South African and non-South African services and according to SARS, if the school fees benefit is received for exclusive use in South Africa it will not be subject to apportionment (SARS 2015:11).

4.2.2 The provisional tax method of tax collection for expatriates not reported on a South African payroll

The provisional tax issue has been discussed in part 3.7 of this research report. De Koker and Williams (2017: 21-1) state that provisional taxpayers are required to make and may volunteer advance payments, known as provisional tax payments, on account of their estimated liability for normal tax for a particular year of assessment.

Effective 1 March 2017, expatriates who are paid by an employer who is not resident in South Africa are required to register as provisional taxpayers and submit provisional tax returns together with the corresponding tax payments as provided for in paras 1, 17, 19 and 21 of the Fourth Schedule to the Income Tax Act.

With certain exceptions, all provisional taxpayers are obliged to make two obligatory estimates of taxable income for each year of assessment in terms of para 21 of the Fourth Schedule to the Income Tax Act. Para 21 of the Fourth Schedule to the Income Tax Act provides that the first of these estimates must be made on or before the last day of the sixth month of the year of assessment, while the second estimate must be made on or before the last day of the year of assessment. These estimates are essentially artificial in nature, in as much as they must be compiled in terms of specific rules rather than in terms of actual estimates of taxable income .

The first payment must be half of the tax payable, based on the estimated taxable income. The second payment must be the full amount of the tax payable, based on the estimate of taxable income accompanying the second payment.

Individual provisional taxpayers may make further, voluntary provisional tax payments for the purpose of avoiding or reducing a liability for interest that would arise should their first two, obligatory payments be inadequate. These voluntary payments (colloquially referred to as 'topping-up payments') will themselves give rise to a liability for interest if they are made more than six months (or seven months where the taxpayer's year of assessment ends at the end February) after the end of the year of assessment. (De Koker and Williams (2017: 21-1).)

Late or incorrect payments of tax and a failure to submit estimates or adequate estimates may occasion a variety of sanctions, including additional tax, penalties and interest (De Koker and Williams 2017:21-1).

De Koker and Williams (2017: 19 – 1) state that, predictably, many taxpayers seek ways of arranging their affairs so as to escape tax or to reduce or postpone their liability. There is an

established and fundamental distinction in this regard between tax avoidance and tax evasion De Koker and Williams (2017: 19 – 1).
Haupt (2017:633) states that tax avoidance is an attempt to minimize a tax liability using legal means for example, to regulate your affairs in such a way that you pay the minimum tax imposed by the Income Tax Act rather than the maximum.
Tax evasion is the use of illegal means to reduce a tax liability for example, suppression of income, fraudulent non-disclosure of income (Haupt 2017:633).
Stiglingh et al (2017: 812) state that the Income Tax Act contains various provisions that are designed to prevent or counter specific schemes or operations aimed at the avoidance of tax.

It is submitted that by implication, the inclusion of general anti-avoidance rules into the Income Tax Act is a clear example of how the legislators perceive the notion of tax avoidance namely that if taxpayers are left unchecked they are likely to employ schemes in order to avoid tax.

Following the discussion above with regard to tax avoidance and tax evasion namely, that taxpayers seek ways to escape or reduce their tax liability, it is submitted that the provisions of the Tax Administration Act ss 22 to 24 (which deal with tax registration requirements) read together with ss 66 to 67 of the Income Tax Act (which deal with a notice issued by the Commissioner to submit tax returns and registration as taxpayer respectively) place impractical reliance on individual taxpayers, particularly expatriates not reported on a South African payroll, to be honest in the handling of their tax affairs by registering themselves as taxpayers[1].

As noted by De Koker and Williams in the above, many taxpayers seek ways to escape tax or to reduce or postpone their liability. Consequently, it is submitted that the reliance on expatriates to be completely honest in the handling of their tax affairs, namely to register themselves for tax, to submit tax returns (annual and provisional) and to pay the correct amount of tax is impractical because there are insufficient regulations in place to identify expatriates who are non-compliant. Explicitly, if an expatriate is not reported on a South African payroll and does not register themselves for tax, currently there is no system in place which is designed to detect non-compliance or to ensure that expatriates who are liable for South African tax are indeed registered for tax. The current Income Tax Act provisions

[1]require an expatriate to register themselves for tax (s 67), it is submitted that it is only at this point where the expatriate be on SARS' radar and that is the time SARS will be able to automatically detect non-compliance.

Consequently, s 67 of Income Tax Act and ss 22 to 24 of the Tax Administration Act which provide for self-registration are a weakness with regard to expatriates (particularly expatriates not reported on a South African payroll) because if they default they may not be easily detected by SARS. However, it is noted that in terms of s 24(2) of the Tax Administration Act, SARS may register and allocate a taxpayer reference number to a person who is not registered. Therefore, in the event where SARS finds that a person who ought to be registered for tax is actually not registered, SARS may invoke the provisions of s 24(2) of the Tax Administration Act by registering and allocating a taxpayer reference number.

4.2.3 Employees' tax withholding on employee share incentive schemes

The supposed flaws of the employees' tax withholding provisions (contained in para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act) have been discussed in part 3.7.1 of this research report. This relates to the provisions which apply where the remuneration of an employee includes any gain made in respect of share incentive schemes as envisaged in s 8A, s 8B and s 8C.

Where the employer/entity which has granted the employee/expatriate with participatory rights to the employee share incentive scheme is a non-resident 'associated institution' in relation to the employer and the associated institution has no representative employer in South Africa or is unable to withhold the employees' tax because the tax due exceeds the cash amount from which it can be deducted or withheld, the associated institution and the employer (who is generally able to deduct the employees' tax) must jointly ensure (and will be jointly and severally liable) that the tax is properly deducted. This situation will most likely arise where the right to the share or other instrument concerned has been granted by a parent company of the employer entity or a share incentive trust (which does not pay cash or remuneration). (De Koker and Williams (2017: 20-1).)

[1] In the author's experience, in majority of instances multinational companies utilize the the Expatriate Tax Services team of reputable audit firms such as Deloitte, PWC, KPMG, Ernst&Young, who understand the complexities pertaining to expatriate taxes. These companies assist the employer and the expatriates to minimize the tax burden, avoid risk and ensure that both the employer and the expatriates are tax compliant in all locations.

It is submitted that the daunting withholding obligation bestowed by the above provision means that the South African employer (which is an associated institution to the foreign employer or non-resident parent company which issued the shares/administers the employee share scheme) will be held responsible for employees' tax withholding on remuneration received or accrued with reference to an equity instrument acquired by virtue of employment even when the participatory rights to the employee share incentive scheme were not granted directly by the South African employer to the employee. This is to say, where an expatriate is seconded to South Africa by a parent company of the South African employer and that expatriate, while on secondment in South Africa, is a participant of the parent company's employee share incentive scheme, the South African employer together with the parent company will be jointly liable for the employees' tax on the remuneration arising out of the expatriate's participation in the employee share incentive scheme even though the South African employer was not party to the granting of those shares and may not have been aware of such an arrangement.

A further weakness with the above provisions (discussed in part 3.7.1 of this report) is the ability for SARS to enforce the employees' tax withholding liability on the non-resident employer. Based on the scenario above, where employee shares are granted by a non-resident parent company which is an associated institution, it is submitted that the enforceability of the legislation (employees' tax withholding on the remuneration from the shares) upon the non-resident parent company is limited since the parent company may not be paying remuneration in South Africa and the efforts or the costs of recovering the employees' tax from the parent company, in the event of a default, could surpass the tax collected. It is submitted that this provision seems to contravene the fourth maxim of a good tax system which determines that the cost of collecting taxes should be significantly low in comparison to the tax collected.

4.3 Application of a Double Tax Agreement

An expatriate who earns employment income from a source within South Africa, and who is a resident of another country, may be liable for income tax both in South Africa and the expatriate's country of residence (SARS 2015: 43). The South African government has however entered into tax treaties with a number of other countries to prevent the levying of income tax on the same income by more than one country (SARS 2015: 43).

Stiglingh et al (2017: 623) indicate that in determining the South African tax implications for an expatriate one needs to consider the South African domestic legislative tax provisions and also to consider the impact of any double tax agreement, if such an agreement exists between South Africa and the other country. **If such an agreement exists, it overrides the provisions of the South African Income Tax Act (**Stiglingh et al 2017: 623**).**
The domestic laws of both South Africa and the relevant foreign country remain applicable where no tax treaty exists (SARS 2015: 43).

4.3.1 Overview of Double Tax Agreements

The main object of a tax treaty is reflected in its preamble or title, which usually reads 'the avoidance of double taxation and the prevention of fiscal evasion' (Olivier and Honiball 2011:276). Olivier and Honiball (2011:276) also state that tax treaties are generally aimed at relieving double taxation.

Haupt (2017:628) states that the problem of international double tax arises because of the different ways in which different countries levy tax. The consequence of the use of different bases of tax in different countries could be the taxation of the same amount of income in two or more different countries (Haupt, 2017: 628).
According to Haupt (2017: 628) double tax in two countries may arise in the following ways:

- One country taxes on a source basis while the other taxes on a residence basis, and the source of the income is in one country and the recipient of the income is resident in the other country.
- Both countries tax on a residence basis but have different definitions of residence i.e. in terms of the domestic law of each country the same person is resident in both countries.
- Both countries tax on a source basis but have different definitions of source.
- Both countries tax on a residence basis for residents, but on a source basis for non-residents. This is one of the most common reasons for double tax.

Haupt (2017: 628) states that in order to try and alleviate the issues surrounding double tax most developed countries have embarked on a strategy to enter into tax treaties/agreements with other jurisdictions in particular with their significant trading partners.

As stated by Haupt (2017: 629) the main purpose of a double tax agreement is to:

- Resolve conflict arising from source and residence

- Determine the taxing rights of the different countries who are parties to the double tax agreement
- Set maximum levels of tax in situations where double tax is permitted.

For the purposes of this research report, the provisions of a typical double tax agreement between South Africa and another country will be examined. Therefore, this report will examine the double tax agreement between South Africa and the United Kingdom with reference to employment income derived by an expatriate from the UK on assignment in South Africa.

South Africa is an observer to the OECD and may base its tax policy reforms on the OECD Model Tax Convention (OECD online 2004) (as discussed in part 3.5.1 above), it is the author's view that South African double tax agreements are largely based on the OECD Model Tax Convention. The OECD Model Tax Convention provides for the relief of juridical double taxation (circumstances where a taxpayer is subject to tax on the same income or capital in more than one jurisdiction) and not economic double taxation (circumstances where there is a taxation of two different taxpayers with respect to the same income or capital). (Olivier and Honiball 2011: 277). Olivier and Honiball (2011: 277) note that where a treaty does not provide for relief of economic double taxation, taxpayers have to seek relief under domestic legislation.

4.3.2 Expatriates working in South Africa for less than 183 days

According to SARS (2015:44) the employment income of an expatriate will generally be subject to income tax in South Africa even if a tax treaty has been concluded with a foreign country. However, if all three of the requirements (for example, as shown below, as provided in article 14 of the South Africa/United Kingdom double tax agreement) are met, the income will generally not be subject to income tax in South Africa under the tax treaty (SARS 2015:44):

Article 14 of the South Africa/United Kingdom double tax agreement provides that remuneration derived by a resident of the United Kingdom (the expatriate) in respect of employment services performed in South Africa shall only be taxable in the United Kingdom if:

- The expatriate is physically present in South Africa for a period or periods in aggregate not exceeding 183 days in any 12-month period commencing or ending during a year of assessment (not during a specific year of assessment).

  Equivalent provisions in other double tax agreements, for example the double tax agreement between South Africa and Germany, requires that the expatriate is physically present in South Africa for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned (year of assessment concerned;) **and**

- The remuneration is paid by, or on behalf of, an employer who is not a resident of South Africa.

  The important thing to bear in mind is that South Africa adopts an economic employer approach (discussed in part 4.3.3 below) and therefore, in instances where there is a recharge of employment costs to the South African entity, the second condition of the double tax agreement relief will not have been met namely the requirement which provides that in order for an expatriate to enjoy relief under a double tax agreement, the remuneration must be paid by, or on behalf of, an employer who is not a resident of South Africa. This is to say, in instances where there is a recharge of employment costs, the second test provided to qualify for double tax agreement relief will fail and double tax agreement relief will not be available (SAICA online: 2004); **and**

- The remuneration is not borne by a permanent establishment that the employer has in South Africa.

  Expanding on the third test for double tax agreement relief as provided above, a permanent establishment in essence means a fixed place of business through which the business of the employer is wholly or partly carried on (SARS 2015:44). The concept of permanent establishment as provided in article 5 of the South African/United Kingdom DTA, includes a place of management, a branch or an office of the foreign entity, operating in South Africa and vice versa. Therefore, to the extent that the South African branch office pays or is charged for the expatriate's remuneration, the expatriate would not meet the third test provided to qualify for double tax agreement relief and double tax agreement relief will not be available (SAICA online: 2004).

Article 5 of the South Africa/United Kingdom double tax agreement (and found in equivalent articles of a typical double tax agreement) provides circumstances where a non-resident entity may create a permanent establishment in South Africa due to the entities presence through its employees or other operations in South Africa. To this effect, multinational companies who send expatriates on foreign assignments utilise the services of reputable audit firms (as mentioned in footnote 1 on page 56) to counter such risks or exposure.

4.3.3 Economic employer principle

In terms of the *OECD Model Tax Convention on Income and on Capital* (2008: 213, paragraph 3), the term 'economic employer' is an adaptation of:

> 'the term "employer" which should be interpreted in the context of paragraph 2. In this respect, it should be noted that the term employer is not defined in the Convention but it is understood that the employer is the person having rights on the work produced and bearing the relative responsibility and risks.'

Under part 4.3.2 of this report, the report examined the circumstances under which expatriates will qualify for double tax agreement relief which results in the expatriate being subject to tax in his/her country of tax residence and South Africa providing tax relief by not taxing the remuneration in South Africa per the double tax agreement provisions.
The three double tax agreement provisions (found in article 14 of the South Africa/United Kingdom double tax agreement) which provide relief in relation to the taxation of remuneration in South Africa are:

- The expatriate is physically present in South Africa for a period or periods in aggregate not exceeding 183 days in any 12-month period commencing or ending during a year of assessment, and
- The remuneration is paid by, or on behalf of, an employer who is not a resident of South Africa, and
- The remuneration is not borne by a permanent establishment that the employer has in South Africa.

However, in the *SARS Binding Private Ruling 85* (discussed below), it seems SARS adopts the 'economic employer' principle as stated in the first paragraph of part 4.3.3, namely that the South African company, despite the fact that it is not the legal employer of the expatriates, is the economic employer since it has rights on the work produced and bears the

relative responsibility and risks on the work performed by the expatriates in South Africa. It seems that SARS took the view that the salary costs of expatriates were recharged to the South African company since it paid an amount to the formal non-resident employers for the services rendered by the expatriates in South Africa.

For this reason, out of the three double tax provisions (discussed above) which provide relief in relation to the taxation of remuneration in a contracting state, the second requirement (found in article 14 of the South Africa/United Kingdom double tax agreement and found in equivalent articles of a typical double tax agreement), namely that 'the remuneration is paid by, or on behalf of, an employer who is not a resident of South Africa' is not met. Consequently, the expatriates do not qualify for double tax agreement relief in South Africa since not all three of the requirements have been met.

The *SARS Binding Private Ruling 85* (2010) deals with whether South Africa has a right to tax the remuneration derived by residents of India, the USA, Romania, the Czech Republic, the UK or the Netherlands for employment in South Africa in terms of the interpretation and application of the articles of the relevant double tax agreements. This ruling also deals with the obligation of the South African employer to withhold employees' tax in respect of that remuneration in terms of para 2 of the Fourth Schedule to the Income Tax Act.

Description of the proposed transaction in the SARS Binding Private Ruling 85

- A foreign company will, as a labour broker, provide employees from either India, the USA, Romania, the Czech Republic, the UK or the Netherlands to a South African company that is a 'resident' as defined in s 1 of the Income Tax Act.
- The employees/expatriates will be remunerated and continue to be formally employed by the labour broker with part-benefits paid by the South African company (accommodation, local and international transportation and meals or daily allowances to these expatriates whilst on their assignments in South Africa) but will be subject to the supervision and control of the South African company.
- The employees/expatriates will be in South Africa for less than 183 days and the South African company will pay an agreed rate to the labour broker for providing these employees.

Ruling

> 'The South African company will be regarded as an "employer" of these assigned employees for the purposes of:
> (i) Article 15 of the DTA's between the Government of South Africa and each of India, the USA, Romania and the Czech Republic;
> (ii) Article 14 of the DTA between the Government of South Africa and the UK; and
> (iii) Article 16 of the DTA between the Government of South Africa and the Netherlands.
>
> South Africa shall be entitled to tax the remuneration, paid to these Assigned employees by these Associated foreign companies during these Assigned employees' assignments to South African projects, in terms of the DTAs that the Government of South Africa have entered into with the Governments of the foreign countries of residence of these Assigned employees.
>
> The South African company shall be obliged to comply with the obligations of an employer as prescribed in paragraph 2 of the Fourth Schedule in respect of remuneration paid to these Assigned employees by these Associated foreign companies in their respective country of residence in respect of services rendered by these Assigned employees during their assignments to South African projects.'

In *SARS Binding Private Ruling 85* (2010), at face value, it seems that the expatriates will meet the requirements for double tax agreement relief since they were present in SA for less than 183 days, their remuneration was paid by South African non-resident employers and the remuneration was not borne by a permanent establishment in South Africa.
However, in terms of the *SARS Binding Private Ruling 85* (2010) the expatriates did not meet the second requirement of the double tax agreements which South Africa has entered into with the respective countries of residence of the expatriates, namely that their remuneration was paid by South African non-resident employers. Therefore, the expatriates were subject to tax in South Africa.

It seems in this instance that SARS adopted an economic substance over form approach as the ruling states that the South African company shall be regarded as an employer of the expatriates in this instance despite the actual employer being the labour broker. This approach is commonly referred to as the 'economic employer' approach/principle.

Adopting the above economic employer approach may lead to double taxation i.e. South Africa is taxing the expatriate on the remuneration earned in South Africa even though double tax agreement relief under article 14 of the South African/United Kingdom DTA (and equivalent articles in other typical double tax agreements) seems available and the

expatriate's home country taxes the same remuneration as it has the taxing rights over the remuneration in terms article 14 of the South African/United Kingdom DTA and equivalent articles in other typical double tax agreements between South Africa and the respective country which is party to the double tax agreement.

The author of this report takes a critical view of the part of the ruling of the part of the ruling which states that, the South African company shall be liable for employees' tax compliance as an employer as prescribed in para 2 of the Fourth Schedule to the Income Tax Act in respect of remuneration paid to the expatriates, on the basis that the relevant provisions of para 2 of the Fourth Schedule to the Income Tax Act apply to the extent that the South African resident employer or representative employer pays remuneration to the expatriates. Therefore, the South African company should only have a employees' tax withholding liability on the remuneration elements which it was obliged to pay (accommodation, local and international transportation and meals or daily allowances) and not on the foreign remuneration paid by the associated foreign companies who are the legal employers as the South African company is not a representative employer of the associated foreign companies. Therefore, this research report concludes that that said part of the ruling (employees' tax withholding liability imposed on the South African employer on foreign remuneration paid by the associated foreign companies) falls outside the ambit of the provisions of para 2 of the Fourth Schedule to the Income Tax and would almost certainly not be enforceable.

4.4. End of chapter summary

It is submitted that the South African tax system incorporates the four maxims of a good tax system envisaged by Adam Smith as discussed in part 4.1 above. The following examples (laid out in the respective order of how they relate to the rephrased four maxims of a good tax system) are testament to this notion:

- Equity or inequality of taxation – the annual tax liability for individuals is calculated on a sliding scale i.e. the tax rates are progressive, the higher one earns the more taxes they pay (s 5(1) and s 5(2) of the Income Tax Act).
- Tax liability ought to be certain, the time and manner of payment ought to be clear – the Minister of Finance pronounces changes to the tax rates at the tabling of the annual budget speech which serves as a notice to the taxpayers of the changes for the upcoming tax year. Otherwise the provisions of s162 of the Tax Administration Act afford clear

communication of the Commissioner's intention to provide clarity and certainty on the time and manner of payment of tax.

- Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it – in terms of the definition of gross income in s 1(1) of the Income Tax Act, an individual will be taxed on the receipt or accrual of an amount which means that the tax liability only arises at the point where the taxpayer has a right to the amount which makes it the opportune time for the tax to be payable.
- The cost of collecting taxes should be significantly low in comparison to the tax collected – in South Africa tax is collected by means of various withholding taxes (like employees' tax) and provisional tax. Payment of tax through the method of withholding makes collection simpler and more efficient for SARS, but by placing a compliance burden on the withholding agents.

Notwithstanding the best efforts to align the South African tax system to the maxims of a good tax system (established by Adam Smith) as noted above, there is still room for improvement with regard to the current legislative provisions in relation to the taxation of expatriates.

According to De Koker and Williams (2017: 5-24-1) there is no general provision in the Act that provides for a deemed source in relation to amounts derived from employment or for services rendered.
Therefore, it is submitted that the absence of general sourcing provisions in relation to remuneration or the absence of provisions for the apportionment of a source of income, as highlighted by De Koker and Williams above, is a fundamental problem for both the expatriates and SARS.
There is a notion that taxpayers seek ways to escape or reduce their tax liability, it is submitted that the provisions of the Tax Administration Act ss 22 to 24 (which deal with tax registration requirements) read together with ss 66 to 67 of the Income Tax Act (which deal with a notice issued by the Commissioner to submit tax returns and registration as taxpayer respectively) place impractical reliance on individual taxpayers, particularly expatriates not reported on a South African payroll, to be honest in the handling of their tax affairs by registering themselves as taxpayers.

The report determines that the employees' tax withholding provisions (contained in para 11A(1) and (2)of the Fourth Schedule to the Income Tax Act) which apply where the

remuneration of an employee includes any gain made in respect of share incentive schemes as envisaged in s 8A, s 8B and s 8C are misplaced, weak and not easily enforceable.

When determining the circumstances under which expatriates may qualify for double tax agreement relief which results in the expatriate being subject to tax in his/her country of tax residence and South Africa providing tax relief by not taxing the remuneration in South Africa per the double tax agreement provisions, one needs to take cognisance of economic employer principles as laid out in the *SARS Binding Private Ruling 85* (2010).
The economic employer principle has the effect that a South African company, despite the fact that it may not be the legal employer of expatriates working in South Africa, is the economic employer since it has rights on the work produced and bearing the relative responsibility and risks on the work performed by the expatriates in South Africa.

5. How can the problems with the current income tax provisions be overcome?

5.1 Introduction

Chapter 4 of this research report identified the following issues to be problematic:

1) Remuneration sourcing and apportionment in relation to expatriates
2) The provisional tax method of tax collection for expatriates not reported on a South African payroll
3) Employees' tax withholding on employee share schemes administered by non-resident employers
4) Application of a Double Tax Agreement with regard to expatriates who spend less than 183 days in South Africa

In this chapter the research report provides possible solutions to the above identified problems which will assist in strengthening the Income Tax Act provisions so that the South African tax system is enhanced in terms of dealing with expatriate taxes.
The proposed solutions will in turn enable SARS to reach their mandate/objectives which are the collection of revenue in an efficient and effective manner and be able to better enforce the national legislation which is administered by the Commissioner for SARS in terms of the provisions of ss 3 and 4 of the South African Revenue Service Act.

5.2 Remuneration sourcing and apportionment

5.2.1 Remuneration sourcing

One of the issues with the current tax provisions identified in part 4.2.1 of this report is the sourcing of remuneration in particular where expatriates are on a formal assignment or employment in South Africa however, they may perform employment services both in and outside of South Africa.

It is evident, based on the discussions in part 4.2.1 of the report, that the absence of general provisions in the Income Tax Act which provide for a deemed source in relation to amounts derived from employment or for services rendered can lead to conflicting interpretations.
It is therefore submitted that the legislators should consider including specific/special deeming provisions for remuneration sourcing in relation to expatriates who perform services

in and outside of South Africa. For instance the proposed legislative amendments should address the sourcing of cash remuneration, allowances and fringe benefits which are linked to the South African employment or assignment. SARS, in its guide (SARS 2015:11), has already indicated that fringe benefits which are for exclusive use/enjoyment in South Africa will not be subject to apportionment which means SARS deems their source to be South Africa.

A SARS guide does not have the force of law but merely sets out SARS' interpretation of the law (Haupt 2017:14). Therefore, SARS' interpretation that fringe benefits which are for exclusive use/enjoyment in South Africa will not be subject to apportionment may be challenged by a taxpayer. However, the point to note is that this interpretation, as much as it is not law, is representative of how SARS will assess or interpret these types of fringe benefits. Consequently, in issuing a tax assessment SARS will almost certainly disregard or disallow an apportionment applied on fringe benefits which are for exclusive use/enjoyment in South Africa. Although this matter may be challenged by a taxpayer by submitting an objection or appeal under ss101 to 150 of the Tax Administration Act, it may give rise to administrative burdens for expatriates who have to submit objections/appeals to have the assessments overturned and the expatriates may have to employ the services of a tax practitioner (since the expatriates may not be familiar with the South African tax laws) for this process which means expatriates suffer undue tax administrative costs.

The wording on the guide itself could be construed as misleading as the principles of source discussed in part 3.3 and 3.4 of this research report indicate that the source of income from employment and other services rendered is where the services are physically rendered, irrespective of the place where the contract is made or the remuneration is paid (De Koker and Williams 2017:5-22). Therefore, the notion that remuneration or fringe benefits which are for exclusive use/enjoyment in South Africa are seemingly to be from a South African source is incorrect.

In the event that SARS' interpretation, discussed in the paragraph above, is an indicator of how SARS would desire the legislation to be drafted, then SARS needs to issue a proposed amendment to the Income Tax Act provisions following the applicable legal provisions of amending an act which is in force. The proposed amendments would be in the form of special deeming provisions with regard to the source of remuneration (fringe benefit) which is for

exclusive use/enjoyment in South Africa. Or else SARS needs to amend the wording of the guide as it is misleading in its current form.

Irrespective of the route that SARS may follow, whether proposing an amendment to the legislation or amending their guide, this will result in clarity of the law and may lead to less conflicting interpretations.

5.2.2 Remuneration apportionment

SARS (2015:10) accepts that remuneration received by an expatriate for services rendered inside and outside South Africa may be apportioned based on the number of days worked in and outside of South Africa during a year of assessment. However, SARS seems to hold the view that fringe benefits which are for exclusive use/enjoyment in South Africa will not be subject to apportionment (SARS 2015:11).

The absence of legislation or a uniform approach in terms of whether work days (with regard to apportionment of qualifying remuneration) or calendar days (with regard to the apportionment of remuneration from gains realized under an employee share incentive scheme discussed in part 3.7.1of this report) should be used for apportionment, can be confusing.

It is submitted that legislators should consider including legislative provisions which will provide for remuneration apportionment. It is further proposed that SARS issues a guide which will illustrate and explain situations where remuneration apportionment will be applicable.

Furthermore, the legislation should prescribe which days should be used for the basis of remuneration apportionment. If the legislators consider workdays to be the approach to be adopted, they will need to provide a definition of a workday.
If the legislators consider calendar days to be the approach to be adopted, they will also need to specify which days need to be disregarded when counting days namely leave days, public holidays and the like as already envisaged in the SARS *Income Tax Interpretation Note no 4* (2014).

Another matter that the legislators may want to consider is the implementation of a de minimis rule based on days spent in/outside South Africa. For instance, a provision may be

introduced which specifies that if an expatriate spends less than 10% of the time working outside South Africa then the entire remuneration will be deemed to be South African source and not subject to apportionment.

5.3 The provisional tax method of tax collection for expatriates not reported on a South African payroll

One of the issues with the current tax provisions identified in part 4.2.3 is with regard to the collection of taxes from expatriates who are not paid/reported on a South African payroll, by means of the provisional tax method.

As noted by De Koker and Williams (2017: 19 – 1), many taxpayers seek ways to escape tax or to reduce or postpone their liability. Consequently, the reliance on expatriates to be completely honest in the handling of their tax affairs, namely the obligation to register themselves for tax, to submit tax returns (annual and provisional) and to pay the correct amount of tax is impractical because there are insufficient regulations in place to identify expatriates who are non-compliant.

The provision of s 24(2) of the Tax Administration Act, namely that SARS may register and allocate a taxpayer reference number to a person who is not registered is a helpful provision. However, it submitted that this provision be enhanced specifically with regard to expatriates who are not reported on a South African payroll so that it counters potential non-compliance right at the start of an expatriate's assignment in South Africa.

It is proposed that another subsection be added under s 24(2) of the Tax Administration Act, with the intention of replacing the word 'may' in the current provision of s 24(2) of the Tax Administration Act with the word 'will' with regard to expatriates who are not registered on a South Africa payroll. So the new subsection will read 'that SARS **will** register as a provisional taxpayer and allocate a taxpayer reference number to a person who is not registered'. This proposed addition to the legislation should be subject to a proviso which states that upon arrival in South Africa (to effect the terms of a work permit) an expatriate will be registered by SARS if that expatriate is issued with a work permit under the provisions of the Immigration Act 13 of 2002 and the work permit is issued for a period in excess of 183 days. In order for this proposed change to the legislation to be effective, Home

Affairs would be required to advise SARS of persons who arrive in South Africa with the relevant work permit.

The proposed subsection, even though it might not be a catch all provision, will at least target expatriates who may spend more than 183 days in South Africa. These expatriates will almost certainly not qualify for relief under a double tax agreement that South Africa may have with the expatriate's country of tax residence (since they may have spent more than 183 days in South Africa). This provision makes certain that SARS is able to bring into the tax net the expatriates who fall under the above circumstances and less reliance is placed on the expatriate's honesty.

The proposed subsection would have to provide for returning South African citizens, who are not South African residents, who are back in South Africa as expatriates on a short term assignment since they may not be working in South Africa under a work permit issued in terms of the Immigration Act 13 of 2002.

Alternatively, SARS should look at other ways of working closely with the Department of Home Affairs, since the Department of Home Affairs is the first government department which expatriates will contact for immigration purposes since the expatriates may not enter the country legally without having the correct permits which are issued by the Department of Home Affairs (s 9(4) of Immigration Act 13 of 2002). Therefore, in partnering up with the Department of Home Affairs, SARS would also be able to monitor the movements of expatriates and perhaps on final exit (repatriation) from the borders of South Africa expatriates are required to produce a valid tax compliance status document (formerly known as a tax clearance certificate) issued in terms of s 256 of the Tax Administration Act before they obtain clearance to exit South Africa. However, the provisions of s 256 of the Tax Administration Act may need to be adapted for expatriate circumstances and may be SARS could consider placing competent officials at the ports of exit from South Africa, since SARS already has Customs officials stationed at these ports, who are able to handle the tax compliance status matters as and when they arise. These stringent rules should however, only apply to expatriates who have been in South Africa for more than 183 days having entered South Africa under a work permit.

5.4 Employees' tax withholding on employee share schemes administered by non-resident employers

Para 2 of the Fourth Schedule to the Income Tax Act provides that every employer who is a resident – or representative employer in the case of a non-resident employer – who pays or becomes liable to pay an amount of remuneration to an employee must deduct or withhold the appropriate amount of employees' tax, unless the Commissioner has granted authority to the contrary (De Koker and Williams 2017: 20-58).

Thus, para 2 of the Fourth Schedule to the Income Tax Act presupposes that the employees' tax/PAYE withholding obligation is the responsibility of a South African resident employer or a representative employer (as defined in para 1 of the Fourth Schedule to the Income Tax Act).

However, there is an exception to this general rule (that employees' tax withholding is an obligation for a South African resident employer or a representative employer), in relation to remuneration received or accrued in terms of s 8A, s 8B and s 8C of Income Tax Act. Sections 8A, 8B and 8C of Income Tax Act contain provisions with regard to the taxation of remuneration from participating in an employee share incentive scheme.

The mentioned exception to the general rule, which is found under para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act, introduces an employees' tax withholding obligation for a foreign 'associated institution' (as defined in para 1 of the Seventh Schedule to the Income Tax Act) where an expatriate receives remuneration from participating in an employee share incentive scheme under the provisions of ss 8A, 8B and 8C of Income Tax Act. An amount accruing to an employee in the form of a dividend, in respect of a restricted equity instrument in terms of s 8C of the Income Tax Act, will be taxable as normal income (s8C(1A) read together with s10(1)(*k*)(i)(*dd*), (*ii*) and (*jj*) of the Income Tax Act). Effective from 1 March 2018 the employees tax withholding obligations under para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act will apply to such dividends.

It is submitted that the provision contained in para 11A(2) is misplaced since the employees' tax charging provision is found in para 2(1) of the Fourth Schedule to the Income Tax Act, which para 2(1) lists the persons who have a liability to withhold PAYE. Therefore, the legislators should consider moving the provisions of para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act to para 2 of the Fourth Schedule. Or alternatively the

legislators should make a cross reference from para 2 to paras 11A(1) and (2) of the Fourth Schedule to the Income Tax Act.

Another proposed alternative is that the above provisions (para 11A (2)) of the Fourth Schedule to the Income Tax Act), which in essence states that the South Africa resident employer and the non-resident associated institution will be jointly and severally liable for withholding employees' tax, be removed and instead the provision should state that the South African resident employer will be held responsible for the employees' tax on remuneration (gains or dividends from employee share incentive schemes) received or accrued with reference to an equity instrument acquired by virtue of employment in terms of ss 8A, 8B and 8C of the Income Tax Act.
The reason for the suggestion is that this provision (para 11A (2) of the Fourth Schedule to the Income Tax Act) seems difficult to enforce and it also seems to be misaligned with the other Fourth Schedule provisions which seek to hold responsible the South African resident entity for employees' tax withholding found in para 2.

In the event that legislators do not amend the provisions of para 11A (2) of the Fourth Schedule to the Income Tax Act, they should consider aligning the provisions of para 11A (2) of the Fourth Schedule to the Income Tax Act with the employees' tax withholding provisions found in para 2 of the Fourth Schedule to the Income Tax Act. To this effect, it is proposed that another provision be added under para 2(1) to include an 'associated institution' as another person who has a liability to withhold employees' tax.

5.5 Application of a Double Tax Agreement with regard to expatriates who spend less than 183 days in South Africa

The *SARS Binding Private Ruling 085* is a classic example of how the interpretation of the double tax agreement may lead to a situation where an expatriate is subject to double tax since SARS did not grant the expatriates appropriate relief (from the point of view of the expatriates) in terms of the applicable double tax agreements. It seems that SARS took the view that the salary costs of expatriates were recharged to the South African company since it paid an amount to the formal non-resident employers for the services rendered by the expatriates in South Africa which therefore, meant that the South African company was the economic employer of the expatriates. Stated more expressly, this interpretation meant that the expatriates were paid by a South African resident employer therefore, the second

condition of the double tax agreement relief will not have been met namely the requirement which provides that in order for an expatriate to enjoy relief under a double tax agreement, the remuneration must be paid by, or on behalf of, an employer who is not a resident of South Africa.

It is recommended that SARS issues an official publication (as defined in s 1 of the Tax Administration Act) to clarify SARS' approach and interpretation of the double tax agreement provisions in relation to income from employment with regard to expatriates working in South Africa for less than 183 days. The interpretation should focus on the provisions found in article 14 of the South Africa/United Kingdom double tax agreement and found in equivalent articles of a typical double tax agreement. The problematic provision in article 14 (or equivalent articles of a typical double tax agreement) is the second condition which provides that 'the remuneration is paid by, or on behalf of, an employer who is not a resident of South Africa'.
The 'official publication' can either take the form of a binding general ruling, interpretation note, practice note or public notice issued by SARS as defined in s 1 of the Tax Administration Act.
Since the official publication would be binding on SARS in terms of the definition of 'official publication' in s 1 of the Tax Administration Act, it would provide certainty and clarity to the expatriates and employers in terms of how SARS will interpret and apply the double tax agreement provisions.

It is recommended that one of the focal areas of the official publication be with regard to the definition of employer in terms of article 14 of the South Africa/United Kingdom double tax agreement and equivalent articles of a typical double tax agreement generally found in articles 14, 15 and 16 of South African double tax agreements with other countries (*SARS Binding Private Ruling 85* (2010: 1).

The proposed official publication would help guide expatriates and employers with regard to SARS' interpretation or application of the provisions of article 14 of the South Africa/United Kingdom double tax agreement and equivalent articles of the double tax agreements between South Africa and other countries.

The official publication needs to explore the term employer used in the second condition of article 14 and provide scenarios where the economic employer principle will apply. A further

clarification needs to be made with regard to the recharge of employment costs in terms of what constitutes a recharge of employment costs.

5.6 End of chapter summary

Chapter 4 of this research report identified the following issues to be problematic with the provisions of the Income Tax Act:

1) Remuneration sourcing and apportionment in relation to expatriates
2) The provisional tax method of tax collection for expatriates not reported on a South African payroll
3) Employees' tax withholding on employee share schemes administered by non-resident employers
4) Application of a Double Tax Agreement with regard to expatriates who spend less than 183 days in South Africa

Chapter 5 formulates possible solutions to the identified problems which will assist in strengthening the Income Tax Act provisions so that the South African tax system is enhanced in terms of dealing with expatriate taxes.

Proposed solution to remuneration sourcing and apportionment in relation to expatriates

It is proposed that the legislators should consider including specific/special deeming provisions for remuneration sourcing in relation to expatriates who perform services in and outside of South Africa.

It is further proposed that legislators should consider including legislative provisions which will provide for remuneration apportionment. It is also proposed that SARS issues a guide which will illustrate and explain situations where remuneration apportionment will be applicable.

Proposed solution with regard to the provisional tax method of tax collection for expatriates not reported on a South African payroll

It is proposed that s 24(2) of the Tax Administration Act be enhanced by adding a new subsection which will read 'that SARS **will** register as a provisional taxpayer and allocate a taxpayer reference number to a person who is not registered. This proposed new subsection is aimed at expatriates who have been issued with a work permit under the provisions of the

Immigration Act 13 of 2002 and the work permit is issued for a period in excess of 183 days. The effect of the enhancement is that SARS will automatically register as taxpayers and issue a tax reference number to expatriates who are in possession of a work permit which is issued for a period in excess of 183 days. In order for this proposed solution to work SARS and the Department of Home Affairs will have to work in partnership.

Proposed solution to employees' tax withholding on employee share schemes administered by non-resident employers

The research findings suggest that para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act is misplaced and the legislators should consider moving these provisions (para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act) to para 2 of the Fourth Schedule. Or alternatively the legislators should make a cross reference from para 2 to paras 11A(1) and (2) of the Fourth Schedule to the Income Tax Act.

A further, suggestion is that para 11A (2) of the Fourth Schedule to the Income Tax Act should state that the South African resident employer will be held responsible for the employees' tax on remuneration arising out of the right to participate in an employee share incentive scheme (gains or dividends from employee share incentive schemes) since it would be much easier and more cost effective to collect employees' tax from a South African resident employer.

Proposed solution to the application of a Double Tax Agreement with regard to expatriates who spend less than 183 days in South Africa

It is proposed that SARS issues an official publication (as defined in s 1 of the Tax Administration Act) to clarify SARS' approach and interpretation of the double tax agreement provisions in relation to income from employment with regard to expatriates working in South Africa for less than 183 days.

This proposal seeks to address a situation where expatriates find themselves in a double tax situation, where they may have thought that they will qualify for relief under a double tax agreement which South Africa has with their country of tax residence, as evidenced in the *SARS Binding Private Ruling 85*.

The official publication needs to explore the term employer used in the second condition of article 14 and provide scenarios where the economic employer principle will apply.

The implementation of the above solutions would assist in strengthening the Income Tax Act provisions so that the South African tax system is enhanced in terms of dealing with expatriate taxes.

6. Conclusion

6.1 Overall conclusion

It is evident that, from an expatriate's point of view, the most critical point to consider for tax purposes in South Africa is tax residence as this determines how the expatriate will be taxable in South Africa as provided for in s 1(1) of the Income Tax Act.

ITC 1807 (2006:156) notes that, if an expatriate is in South Africa temporarily and does not consider South Africa as his/her real home or a place to which he/she will return to from his/her wanderings, the expatriate will not become ordinarily resident in South Africa for tax purposes. However, an expatriate may become resident for tax purposes in South Africa in terms of the definition of a resident in s1(1) of the Income Tax Act (physical presence test) should he/she meet the days requirements, that is, an expatriate will satisfy the physical presence test in the sixth year of assessment being physically present in South Africa provided he/she were not ordinarily resident in South Africa at any stage within the preceding 5 years of assessment.

Expatriates are potentially taxable on South African sourced remuneration which forms part of their gross income (paras (*c*) and (*i*) of the definition of gross income) together with South African sourced investment income which (all together) makes up their South African sourced taxable income. Expatriates are liable for income tax on their taxable capital gains in terms of s 26A of the Income Tax Act as determined in terms of the Eighth Schedule to the Income Tax Act. Taxable capital gains with regard to non-residents applies to immovable property (or an interest in such property) located in South Africa as provided in paras 2(*b*), 3 and 4 of the Eighth Schedule to the Income Tax Act.

De Koker and Williams (2017: 5-22) confirm that the Special Court for Hearing Income Tax Appeals (now the Tax Court) has consistently held that the source (in the sense of the 'originating cause') of income from employment and other services rendered is the services, irrespective of the place where the contract is made or the remuneration is paid.

In ITC 77 (1927: 73) it was established that in the application of the source tests, regard must be had to the contract of employment in order to ascertain whether the employee has contracted to render services both within and outside the Republic. If he has so contracted,

the remuneration relating to the services rendered outside the Republic would not be from a South African source. But if he has not contracted to render services outside the Republic, the full remuneration must be from a Republic source, even though occasional or casual services are performed outside the Republic.

Under the South African Income Tax Act as presently constituted, there are no provisions for the apportionment of a source of income Stiglingh et al (2017: 73).

According to the research findings as discussed in part 4.2.1 of this research report, the absence of general sourcing provisions in relation to remuneration or the absence of provisions for the apportionment of a source of income, as highlighted by De Koker and Williams above, is a fundamental problem for both the expatriates and SARS.

It is apparent that the income sourcing provisions as found in s 9 of the Income Tax Act and interpreted by the South African courts (in *CIR v Lever Brothers and Unilever Ltd, CIR v Black* and ITC 77 need to be further developed to address remuneration sourcing provisions which will cater for expatriates working in South Africa.

SARS (2015:10) accepts that remuneration received by an expatriate for services rendered inside and outside South Africa may be apportioned based on the number of days worked in and outside of South Africa during a year of assessment. However, SARS seems to hold the view that fringe benefits which are for exclusive use/enjoyment in South Africa will not be subject to apportionment (SARS 2015:11).

The outcomes of the research report (as discussed in part 4.2.1 of this research report) propose that legislators should consider including legislative provisions which will provide for remuneration apportionment. It is also proposed that SARS issues a guide which will illustrate and explain situations where remuneration apportionment will be applicable as discussed in part 5.2.2 of this report.

The research findings, as noted in part 3.8 of this research report, suggest that it would be more favorable, for expatriates who are working or assigned to South Africa on a short term assignment (where the expatriate's country of tax residence has a lower tax rate than South Africa), to remain non-resident in South Africa for at least the first five years of assessment (following his/her physical arrival in South Africa). The reason why it seems more favorable

for an expatriate (in contrast to a resident who is subject to tax in South Africa on his/her worldwide income) to remain non-resident in South Africa for the first five years of assessment (following his/her physical arrival in South Africa) is because for the first five years of assessment of being physically present in South Africa the expatriate will only be taxable in South Africa on South African sourced income in terms of the gross income definition in s 1(1) of the Income Tax Act. This position (non-resident position) works in the favor of an expatriate in cases where an expatriate is in receipt of other income from sources which are outside of South Africa.

Non-residents may benefit from apportionment (in comparison to a resident) meaning that an expatriate's remuneration may be subject to apportionment between South African and non-South African services where the expatriate is required to perform core services in and outside South Africa taking into account the terms of the employment contract as noted by De Koker and Williams (2017: 5-22). Consequently, the expatriate's South African sourced gross income (as defined in s 1(1) of the Income Tax Act) will be a lesser amount should they qualify for remuneration apportionment, this will result in a reduced tax liability in South Africa.

It was found that the provisions of the Tax Administration Act ss 22 to 24 (which deal with tax registration requirements) read together with ss 66 to 67 of the Income Tax Act (which deal with a notice issued by the Commissioner to submit tax returns and registration as taxpayer respectively) place impractical reliance on individual taxpayers, particularly expatriates not reported on a South African payroll, to be honest in the handling of their tax affairs by registering themselves as taxpayers.

The research report recommends that SARS automatically register as taxpayers and issue a tax reference number to expatriates who are in possession of a work permit which is issued for a period in excess of 183 days. In order for this proposed solution to work SARS and the Department of Home Affairs will have to work in partnership.

The report determines that the employees' tax withholding provisions (contained in para 11A(1) and (2)of the Fourth Schedule to the Income Tax Act) which apply where the remuneration of an employee includes any gain made in respect of share incentive schemes as envisaged in s 8A, s 8B and s 8C are misplaced, weak and not easily enforceable. Therefore, they need to be amended as discussed in part 4.2.3 of the research report.

As discussed in part 5.1 of this research report, the South African tax system has been designed to align itself with the maxims of a good tax system (established by Adam Smith). The proposals discussed in part 5 of the report (to enhance the provisions of the Income Tax Act) will help keep the South African tax legislation up to date and effective in the current economic times and will keep the tax system aligned to the maxims of a good tax system.

The proposed solution to the current tax provisions are:

- Including specific/special deeming provisions for remuneration sourcing in relation to expatriates who perform services in and outside of South Africa and adding provisions which will provide for remuneration apportionment.
- The enhancement of s 24(2) of the Tax Administration Act so that SARS will automatically register as taxpayers and issue a tax reference number to expatriates who are in possession of a work permit which is issued for a period in excess of 183 days. In order for this proposed solution to work SARS and the Department of Home Affairs will have to work in partnership.
- Legislators should consider moving the provisions of para 11A(1) and (2) of the Fourth Schedule to the Income Tax Act) to para 2 of the Fourth Schedule. Alternatively, the legislators should make a cross reference from para 2 to paras 11A(1) and (2) of the Fourth Schedule to the Income Tax Act. A further proposed alternative is that the South African resident employer should be held responsible for the employees' tax on remuneration arising out of the right to participate in an employee share incentive scheme.
- SARS issues an official publication (as defined in s 1 of the Tax Administration Act) to clarify SARS' approach and interpretation of the double tax agreement provisions in relation to income from employment with regard to expatriates working in South Africa for less than 183 days.

6.2 Areas of further research

This research report mainly focused on the current tax provisions which are applicable to expatriates and the challenges surrounding them. There was no research done on the potential impact of the proposed amendments/recommendations/solutions discussed in part 5 of the research report.

Therefore, it is recommended that further research be done on the following areas:

- A study to focus on which days (calendar or work days) should be used for apportionment basis and why
- A study to focus on how the developed countries apply remuneration apportionment and to check whether applying a de minimis rule based on days would be a good option.

7. REFERENCE LIST

7.1 Books

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Annexure A – Physical presence test diagram *SARS Income Tax Interpretation Note no 4* (2010:10):

