University of the Witwatersrand, Johannesburg

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 specializing in the field of taxation

Tax implications of the proposed repeal and enacted amendment of the foreign employment exemption, section 10(1)(*o*)(ii) on South African expatriates

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ABSTRACT

The purpose of this report is to discuss how the proposed repeal and enacted amendment of the foreign employment income exemption, section 10(1)(*o*)(ii) of the Income Tax Act of 1962 (Act 58 of 1962) ('the Act'), impacts on South African expatriates (expats) and its impact on the economy. As a result of the proposed amendment in the draft Taxation Laws Amendment Bill 2017, a comparison will be done to compare South African expatriates in a country with no income tax, such as the United Arab Emirates (UAE), to a country with income taxes such as Australia. With this comparison, the aim is to also determine if National Treasury's purpose of the proposed repeal are met.

National Treasury's main purpose for proposing this repeal was to prevent income earned by South Africans not being taxed in jurisdictions where no tax is imposed on income or in jurisdictions with low tax rates. National Treasury also stated that this exemption creates unequal tax treatment between South African residents employed by a national, provisional or local sphere of government, any public or municipal entity or the private sector (National Treasury, 2017b).

The proposed repeal may be a solution to prevent unequal tax treatments amongst South African residents, as mentioned above; it may however result in unfair tax consequence amongst South African expatriates in counties with similar or lower tax rates than South Africa. This report will also analyse alternative solutions for these expatriates such as double taxation agreements ('DTA') (tax treaties), other exemptions in the Act, such as a section 6*quat* rebate or deduction in respect of foreign taxes on income and change of tax residency.

Key words: foreign income exemption, South African expatriates, double taxation agreements, DTA, section 10(1)(*o*)(ii), Income Tax Act, South Africa, section 6*quat*

DECLARATION

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

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CHAPTER 1: INTRODUCTION

South African residents, other than companies, are entitled to an exemption in respect of remuneration received or accrued in respect of services rendered outside of South Africa, in terms of section 10(1)(*o*)(ii) of the Income Tax Act of 1962 (Act 58 of 1962) ('the Act') (PwC 2017). Section 10(1)(*o*)(ii) deals with the foreign income exemption. This section was inserted into the Act to provide relief to South African residents from double taxation of foreign remuneration.

In recent times, government has become aware that this exemption has created the opportunity for double non-taxation of foreign income for countries where income is not taxed and in other countries where the tax rate is significantly lower than that of South Africa (National Treasury, 2017b). This opportunity by South African expatriates has resulted in National Treasury proposing to repeal the foreign income exemption.

The proposed repeal raises many concerns amongst South African expatriates and the corporate industry as a whole. South African expatriates are concerned about the additional tax liability that they may be liable for, as for some taxpayers they may now have to pay income tax in two jurisdictions. Corporate companies are similarly concerned about the additional cost they may incur. Some companies' factor in the expatriate's cost to company tax liability as a fringe benefit to work in a host country. Due to the repeal resulting in an additional tax liability, companies would need to cater for this additional cost.

Due to the proposed increased tax liability of the expatriate this may result in an increased cost to company of employees for corporates, corporates may reconsider sending their employees to foreign countries. As a result, the economy may be adversely impacted resulting in increased unemployment or even by a lack of skill development due to expatriates not been able to attain the skills from other host countries.

As National Treasury indicated that the double non-taxation of income results in unequal tax treatment between expatriates and South African tax residents, is it fair

to repeal this section resulting in the double taxation of foreign income? The requirements of the foreign income exemption specifically applies to foreign remuneration received by South African residents. This means that other income, other than foreign remuneration, received will not be exempt in terms of this section, but relief may be provided for in terms of other sections of the Act.

These alternative options available for other income, other than foreign remuneration such as interest income, rental income or investment income, would need to be considered to prevent the double taxation of foreign income. Such options would be the reliance on double taxation agreements ('DTAs'), which allows for income to be taxed in the country from which they are sourced, foreign tax rebates which allow for a rebate on taxes paid on foreign income or a change of tax residency status to that of the host country.

To explore the full impact of the proposed repeal and to assess whether the proposed repeal results in fair taxes for all South African residents, this report will look at a comparative study between South African expatriates in Australia and South African expatriates in the United Arab Emirates ('UAE').

Australia has been selected to form part of the study because Australia and South Africa have a DTA and the tax rate in Australia is similar to that of South Africa. The highest marginal tax rate in Australia is 45% which is the same in South Africa. Refer to Tables 1 and 2. Australia is therefore a suitable country to form part of this comparative study as it meets the requirements to assess whether the proposed repeal of section 10(1)(*o*)(ii) results in double taxation of foreign income for South African tax residents.

As stated by Businesstech (2018), 'acording to StatsSA's Community Survey 2016, approximately 102,793 people left the country in the 10 years from 2006 to 2016. The highest proportion of emigrants moved to Australia at 26.0% followed by United Kingdom and United States at 25.0% and 13.4% respectively.' Other countries meet these requirements as well, however, according to Tom Head (2017), Australia is ranked as the second country where South Africans are living

abroad, whereas the United Kingdom is ranked first. Therefore Australia is best suited for the study based on the rankings and tax rates.

In comparison, the UAE has been selected as a comparative country as no income tax is levied and the UAE has a DTA with South Africa. Further, according to Tom Head (2017) the UAE is ranked as the third county where South Africans are living abroad. The UAE is therefore best suited as a comparative country to assess whether the proposed repeal will prevent the double non-taxation of foreign income.

By performing illustrative examples, this report will be able to assess whether National Treasury's objective will be achieved and if the proposed repeal results in fair taxes for all South African residents.

The main focus of the report is to assess the proposed repeal of section 10(1)(*o*)(ii) in terms of the draft Taxation Laws Amendments Bill (2017a) by illustrating the impact of the repeal on expatriate's taxable income. As per the enacted Taxation Laws Amendment Bill (2017c) incorporated in the Income Tax Act 58 of 1962, this section is no longer repealed. Section 10(1)(*o*)(ii) has been amended to allow for the first one million rand of foreign remuneration to be exempt from tax in South Africa, if the requirements of this section are met. The enacted amendment will be factored into this report to consider the impact of the amendment on South African expats as mentioned above.

For the purposes of this report, the following terms will be used, proposed repeal, proposed amendment and enacted amendment. By use of the term proposed repeal reference is made to National Treasury's proposal to repeal section 10(1)(*o*)(ii). The term proposed amendment will be use when reference is made to National Treasury's proposal to amend section 10(1)(*o*)(ii) by insertion of the one million rand threshold on the exemption. This term is used interchangeably with enacted amendment as the proposed amendment to section (10)(1)(*o*)(ii) was enacted and not the proposed repeal.

1. Research Problem

How does the proposed repeal of the foreign income exemption, section 10(1)(*o*)(ii), impact the tax position of South African expatriates?

This research report will examine the impact of the proposed repeal of the foreign income exemption on South African expatriates, by assessing if the proposed repeal achieves National Treasury's objective to remedy the issue of unfair taxes amongst South African residence employed within South Africa and South African residence employed in other tax jurisdictions. This impact will be examined by performing comparative taxable income computations based on the expatriate's income. This report will also address other alternative options to South African expatriates that may be used to limit their South African tax liability.

Australia and the UAE have been identified by Tom Heads (2017) as being two of the top three countries who hosts the most number of South African residents, other than South Africa. A comparative analysis of the tax implications of the proposed and enacted amendments will be performed between expatriates residing in these countries.

The outcome of the comparative study will provide evidence as to whether the proposed repeal and enacted amendments leave South African expatriates in a better or worse-off position in comparison to the current legislation prior to amendments.

2. The Sub-Questions

In order to answer the main research question the following sub-questions will be addressed.

2.1 Why was the foreign income exemption brought into the Act? This will explain the purpose and aim of the foreign employment income exemption and what National Treasury's objective was by implementing this section into the Act.

2.2 Why did National Treasury propose to repeal this section of the Act? By exploring this sub-question, this report will be able to assess what National Treasury was trying to achieve by repealing this section as well as to assess whether the proposed repeal results in fair taxes for all South African residents.

2.3 Consideration as to why National Treasury decided not to repeal section 10(1)(*o*)(ii) of the Act but rather amended this section by inserting the one million rand limitation to the exemption on foreign remuneration? This question will help us analyse whether National Treasury's objectives are being met, and if the initial repeal resulted in unfair tax consequences.

2.4 By preventing non-taxation of foreign income, does the proposed repeal result in double taxation of foreign income in some jurisdictions? This would be as a result of the income that has been taxed in a tax jurisdiction based on that country's Income Tax Act and no foreign income tax relief provided by the South Africa (assuming that section 6*quat* relief, which allows for a rebate or a deduction in respect of foreign tax on income, is not applicable) due to the proposed repeal of the exemption.

2.5 What are the alternative options available for South African expatriates? To achieve fair taxes for all South African residence, alternative options will need to be explored to prevent the double taxation of foreign income. Such alternatives would be DTA, foreign tax rebates and change of tax residency.

2.6 What are the tax implications of the proposed repeal on South African expatriates employed in the UAE? The UAE is a non-income tax jurisdiction. By a South African expatriate not having to pay income taxes in the UAE, the proposed repeal will result in South African expatriates paying taxes in South Africa based on their worldwide income.

2.7 Consideration will be given as to whether a South African expatriate could rely on the DTA between South Africa and the UAE to prevent the income from being taxed in South Africa or rely on the foreign tax rebates in terms of section 6*quat* of the Act. These options may not be available to a South African expatriate as the income is not taxed in the UAE therefore there is no double taxation of the income and no foreign tax rebates will be available. The DTA between South Africa and the UAE will be analysed to confirm if an option is available to South African expatriates, resulting in foreign income being taxed in South Africa. The change of tax residency may be the only option available to prevent the taxation on foreign remuneration in South Africa, as the UAE residents are not taxed on their income.

2.8 What are the tax implications of the proposed repeal on South African expatriates employed in Australia? Australia is a tax jurisdiction with a tax rate similar to that of South Africa. The proposed repeal will result in the foreign income being taxed once in South Africa and once in Australia. Consideration will be given as to whether a South African expatriate will be able to rely on the DTA and foreign tax rebates for relief as well as whether South Africans should change their residency status to avoid the double taxation and the impact of this change.

3. Research Methodology

The research will be of a qualitative and interpretive nature. The primary sources to be analysed will include the Explanatory Memorandum on the Taxation Laws Amendments Bill, 2017 and the Taxation Laws Amendments Bill, 2017 as this will address the main objectives of the report to assess the impact on the tax liability of the proposed repeal to foreign employment income.

Other material will include SARS Interpretation Notes, articles, cases, and income tax legislation of South Africa, Australia and the equivalent in the UAE.

4. Scope and limitations

The scope of this research will be limited to the taxable income of South African expatriate living in Australia and the UAE, and assumes that their gross income is equivalent. This will allow for the quantitative impact of the enacted amendment to be assessed. The focus of the comparative study will be limited to income tax and will not consider other indirect taxes.

5. Chapter Outline

Chapter 2: Background

Prior to 2001, South Africa applied a source-based system of taxation, after which it changed to a residence-based system of taxation. This chapter will look at what is a source-based tax system and what is a residence-based system of taxation, the difference between the aforementioned tax systems, the reason for South Africa changing to a residence-based tax system and why the foreign income tax exemption, section 10(1)(*o*) was introduced into the Act. This chapter will also specifically consider the requirements of section 10(1)(*o*)(ii).

Chapter 3: Proposed repeal and enacted amendment of foreign income exemption

It has come to government's attention that the current foreign tax exemption creates opportunities for double non-taxation in cases where the foreign host country does not impose income tax on employment income or impose taxes at a significantly reduced rate (National Treasury, 2017b). This chapter will go into detail on why National Treasury has proposed to repeal this section of the Act. It will assess whether the double non-taxation of foreign income will be resolved by the repeal of this section and whether it may result in double taxation of foreign income in tax jurisdictions.

The double taxation of foreign income in certain countries my result in unfair tax consequences for South African expatriates as they may be potentially liable for tax in South Africa and the foreign host country. This double taxation may have additional adverse implications as having an increased taxed liability will negatively impact the taxpayer's cash position and they may not be able to afford the standard of living in the host country. This may result in adverse economic effects for host countries as well.

This chapter will further look at the consequences of the proposed repeal which has been amended to allow for a one million rand threshold. National Treasury received numerous comments from expats in summary stating that the tax will have a severely negative impact on finance and remittance to South Africa, especially for those on relatively lower income.

Chapter 4: Alternative options to prevent double taxation of foreign income

The three alternative options available to prevent double taxation of foreign income are the use of DTAs, foreign tax rebates and a change of tax residency. This chapter will go into detail of each option available and its impact on the South African expatriate.

The chapter will analyse the DTA between South Africa and Australia and South Africa and the UAE to assess whether the DTAs prevents double taxation of foreign income.

The requirements of section 6*quat* of the Act will then be assessed to determine if the foreign tax rebate provides full or partial relief for foreign taxes paid and the potential benefits to expatriates.

This chapter will discuss the change in tax residency status as a last resort to avoid paying taxes in South Africa or to prevent double taxation of foreign income. By changing tax residency, section 9H and paragraph 12 of the Eighth Schedule of the Act may take effect resulting in an exit charge. This means that a deemed disposal may be affected resulting in the expatriate been taxed on the market value of all their assets. This may result in adverse tax consequences for the expatriate.

Lastly, this chapter will look at public comments on the proposed repeal of this section to look at alternative options to amending this section rather than the repeal of it. According to le Cordeur (2017b), Kyle Mandy proposes that the minimum days be increased to 325 days to prevent individuals from abusing the law.

Chapter 5: Impact of the proposed repeal and enacted amendment on South African expatriates residing in the United Arab Emirates

The purpose of this chapter is to assess the tax consequences of the proposed repeal and enacted amendment on South African expatriates in a country such as the UAE, due to expatriates not being liable for taxes. This assessment will specifically address National Treasury's aim to prevent double non-taxation of income.

By the use of illustrative examples, this will take into consideration the alternative option available to an expatriate of the UAE to assess the tax implications on the taxpayer's liability.

Chapter 6: Impact of the proposed repeal and enacted amendment on South African expatriates residing in Australia

The purpose of this chapter is to assess the tax consequences of the proposed repeal and enacted amendments on South African expatriates in a country such as Australia, as Australia is a tax jurisdiction with tax rates similar to that of South Africa.

By the use of illustrative examples, this will take into consideration the alternative option available to an expatriate of Australia to assess the tax implications on the taxpayer's liability.

Chapter 7: Conclusion

In this concluding chapter, the analysis made in the preceding chapters will be used to answer the research questions. Areas into which further research may be conducted which were not addressed in this research report will be identified in this chapter.

CHAPTER 2: BACKGROUND

Prior to 2001, South Africa applied a source-based system of taxation, after which it changed to a residence-based system of taxation. 'A source-based system of tax imposes a taxation liability on income arising within a specific jurisdiction or territory' (Robertson, 2012). In other words, 'all income from a source in South Africa and certain types of income which were deemed to be from a source in South Africa were taxable in South Africa' (National Treasury, 2017b).

In comparison to a source-based system of taxation, Robertson (2012) states that 'a residency taxation system is founded on the principle that a state, which provides various services and amenities to its citizens, has a claim against those citizens for the amount required to fund the services it provides'. In other words, a taxpayer will be taxed on income in a jurisdiction to which the taxpayer is a resident.

By South Africa applying a source-based system of taxation, this had the effect that income that was not from a source in South Africa or was not deemed to be from a South African source was not subject to tax in South Africa.

> As a result, section 10(1)(*o*) of the Act granted an income tax exemption only in respect of foreign employment income earned by officers and crew members employed on board any South African ship if those officers and crew members were outside South Africa for more than 183 days during the year of assessment. (National Treasury, 2017b)

When South Africa moved from a source-based system of taxation to a residency-based system of taxation,

> …the scope of the section 10(1)(*o*) of the Act exemption was extended to include South African residents who are outside South Africa for the purposes of rendering services for, or on behalf of, their employer for a period which, in aggregate, exceeds 183 full calendar days during any period of 12 months commencing or ending during a year of assessment. Days spent outside South Africa when a person is not in employment do not qualify as days outside for the purposes of this exemption and would therefore, not be taken into consideration for the purposes of determining the 183 day test. Further, the exemption only applies if, during the same period of 12 months, a person rendered services outside South Africa for a continuous period of at least 60 full days. (National Treasury, 2017b)

The change to a residency-based tax system resulted in taxpayers being taxed on their worldwide income. This means that resident taxpayers working in a foreign county will be taxed on their foreign income in the foreign county and in South Africa. To avoid the double tax of income, Treasury inserted section 10(1)(*o*)(ii) into the Act.

Section 10(1)(*o*)(ii) of the Act, which is effective from 1 March 2020, exempts,

> …any form of remuneration -
>
> …
>
> (ii) to the extent to which that remuneration does not exceed one million rand in respect of a year of assessment and is received by or accrues to any employee during any year of assessment by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, including any amount referred to in paragraph (i) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C, in respect of services rendered outside the Republic by that employee for or on behalf of any employer, if that employee was outside the Republic-
>
> (aa) for a period or periods exceeding 183 full days in aggregate during any period of 12 months; and
> (bb) for a continuous period exceeding 60 full days during that period of 12 months, and those services were rendered during that period or periods: Provided that-

To highlight, the words ‘to the extent to which that remuneration does not exceed one million rand in respect of a year of assessment’ was the amendment to section 10(1)(*o*)(ii). The focus on this report will be on the effects of the proposed repeal and the enacted amendment to the section will be discussed in chapter 3.

The requirements of section 10(1)(*o*)(ii) can be broken down as follows:

1) any remuneration received or accrued to an employee;
2) for services rendered outside the South Africa;
3) if the employee was outside South Africa;
    a. for a period or period exceeding 183 full days in aggregate during any 12 month period; and
    b. for a continuous period exceeding 60 full days during that twelve-month period.

The abovementioned requirements will be further analysed below in line with SARS Interpretation Note 16: Exemption from income tax: Foreign employment income as issued by SARS.

Remuneration

The term 'remuneration' is defined in paragraph 1 of the Fourth Schedule

> …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-

As stated in Interpretation Note 16:

> Not all remuneration qualifies for exemption under section 10(1)(*o*)(ii). The remuneration that qualifies is remuneration received by or accrued to an employee 'by way of' the following amounts, namely, salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, for services rendered. Amounts contemplated in paragraph (i) of the definition of 'gross income' in section 1(1) are also included, as too are amounts referred to in sections 8, 8B or 8C. (SARS, 2017: 2)

Section 8 of the Act refers to allowances, advances, and reimbursements. Section 8B refers to the taxation of amounts derived from broad-based employee share plans and section 8C refers to the taxation of directors and employees on vesting of shares.

As guided by Interpretation Note 16, the foreign income exemption section of the Act applies to remuneration received or accrued for services that were rendered outside the Republic during the qualifying periods. This remuneration will be referred to as foreign remuneration. Periods, to which the South African taxpayer was outside the Republic, where no foreign remuneration was earned, falls outside the ambit of section 10(1)(*o*)(ii). Foreign 'remuneration received subsequent to a qualifying period, but in respect of such qualifying period, will qualify for the exemption, but subject to any applicable apportionment' (SARS, 2017: 2).

Further, foreign remuneration received by or accrued to the taxpayer during the qualifying period for services rendered within the Republic does not qualify for exemption. In other words, section 10(1)(*o*)(ii) is only applicable to foreign remuneration received for services rendered outside of South Africa.

‘Remuneration earned during a qualifying period in respect of services that were rendered both inside and outside the Republic must be apportioned so that only the income relating to foreign services is exempt’ (SARS, 2017: 2).

Employment relationship

The exemption under section 10(1)(*o*)(ii) only applies if an employment relationship exists. This means that the services which are rendered by the taxpayer for or on behalf of the employer must be rendered under an employment contract between the employer and the taxpayer. ‘The term ‘any employer’ means that services rendered to resident or non-resident employers could qualify for exemption (SARS, 2017: 3).’

> The term ‘employee’ is not defined in the main body of the Act, and so must be given its ordinary meaning. An ‘employee’ under the common law excludes an independent contractor or self-employed person. Directors in their capacity as directors are holders of an office, not employees, and to the extent that they earn director’s fees, such fees do not qualify for exemption under section 10(1)(*o*)(ii). (SARS, 2017: 3)

Services Rendered

The foreign remuneration received by the taxpayer must be in respect of services rendered. The scope of the exemption includes amounts payable by an employer to an employee, but remuneration which do not relate to services rendered, are not included in the scope. ‘Payments for the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment or of any appointment (or right to be appointed) to an office or employment (amounts contemplated in paragraph (d)(i) of the definition of ‘gross income’ in section 1(1)) are received by virtue of such termination, loss, repudiation, cancellation or variation, not in respect of services rendered, and are accordingly not exempt under section 10(1)(*o*)(ii) (SARS, 2017: 3)’.

Outside the Republic

As stated in Interpretation Note 16 (SARS, 2017: 3),

> In order to qualify for exemption, the services must be rendered ‘outside the Republic’. The ‘Republic’ is defined in section 1(1). The definition encompasses the landmass of South

> Africa as well as its territorial waters, which is a belt of sea adjacent to the landmass but not exceeding 12 nautical miles (roughly 22,2 km) beyond the baselines of the country.
>
> In certain circumstances, the Republic may extend beyond the geographical limits of its landmass and territorial waters. The definition of the 'Republic' specifically includes those areas beyond the territorial sea which have been designated under international or domestic law as areas where South Africa may exercise sovereign rights in respect of the exploration or exploitation of natural resources. This definition is aligned with domestic law and international law, which provide for South Africa's right to explore and exploit natural resources in the exclusive economic zone and on the continental shelf.
>
> The exclusive economic zone extends to 200 nautical miles (roughly 370,6 km) from the baselines. The continental shelf extends to the outer edge of the continental margin, or 200 nautical miles from the baselines, whichever is the greater.
>
> These are factors that must be considered when determining whether a person renders services in the Republic or outside the Republic, for purposes of section 10(1)(*o*)(ii). Remuneration for services rendered beyond South Africa's territorial seas but within the exclusive economic zone or on the continental shelf will not qualify for exemption under this section if the person's employment services relate to the exploration or exploitation of natural resources.

Period or periods exceeding 183 full days in aggregate

For a taxpayer to qualify for the foreign income exemption, the taxpayer must be in employment, outside the Republic, for at least 183 full days during any 12-month period. As indicated in Interpretation Note 16 (SARS, 2017: 4), a 'full day' means 24 hours (from 0h00 to 24h00). 'The 183 full days do not have to be continuous or consecutive but, in order to meet the exemption requirements, a total of 183 full days in any 12-month period must be exceeded. It is not necessary to exceed this period by a full day. Any amount of time in excess of 183 full days, such as a few hours, will be sufficient.' (SARS, 2017: 4)

Calendar days must be assessed when calculating the period outside of the Republic. When calculating whether a person has been outside the Republic for 183 full days. Calendar days are considered which include only work days, weekends, public holidays, annual leave days, sick leave days and rest periods (as required under the specific terms of a contract of employment) that are spent outside the Republic.

> A distinction must be made between a situation where a person is in employment and is actually outside the Republic but is not physically rendering services, and a situation where a person is physically present outside the Republic but is not in employment. Section

> 10(1)(*o*)(ii) clearly links the days test to the person's employment. Days spent outside the Republic when a person is not in employment do not qualify as days outside the Republic under section 10(1)(*o*)(ii), and are thus not taken into account in the determination of the 183 days for purposes of the exemption. Such broken periods of employment may arise if an employee is employed at intervals. An employee may, for example, be employed on a contract basis and enter into separate employment contracts for each broken period of employment. The time in-between the contracts where the employee is unemployed and where no services are rendered do not qualify under section 10(1)(*o*)(ii) as days outside the Republic. (SARS, 2017: 5)

On the other hand, for the purposes of the day test employees who remain in employment whilst outside South Africa, but only render services for specified periods and then have rest periods, will be able to claim the rest period days as days outside South Africa.

'A common example is where employees work rotational shift periods, such as a specified number of days rendering services followed by an equal number of days of rest. Such rest periods are often required by local health and safety legislation. The rest periods do not interrupt continuous employment, and such days are accepted as falling within the scope of the days test' (SARS, 2017).

Continuous period exceeding 60 full days

Section 10(1)(*o*)(ii) has an additional requirement, that a person must also have rendered services outside the Republic for a continuous period exceeding 60 full days in the same period of 12 months. This is in addition to services must have been rendered outside the Republic for a period or periods exceeding 183 full days in aggregate during any period of 12 months, For example, if a period of 12 months from 1 April 2017 to 31 March 2018 is used to calculate whether the person spent a period or periods exceeding 183 full days in aggregate outside the Republic, that same period of 12 months must be used to determine whether the person spent a continuous period exceeding 60 full days outside the Republic.

As mentioned above, to exceed a continuous period, in this instance is of 60 full days, it does not mean that the da must be exceeded by a full day, but by any amount of time, even if this amounts to, for example, a few minutes or hours.

During any period of 12 months

The foreign remuneration that is exempted by the provision of section 10(1)(o)(ii) relates to amounts earned from services rendered outside the Republic, if the days tests were met during ‘any period of 12 months’.

The word ‘month’ is not defined in the main body of the Act, bearing in mind that the definition of ‘month’ in paragraph 1 of the Fourth Schedule of the Act is not applicable. Section 2 of the Interpretation Act (33 of 1957) provides that, unless the context otherwise requires, the word ‘month’ in any law means a ‘calendar month’. Under dictionary meanings, a calendar month could mean either one of the twelve named portions into which a calendar year is divided, or it could mean a period of time which is calculated from a date in one month to the same date in a successive month.

In *Subbulutchmi v Minister of Police and Another*, approved by the Appellate Division James JP stated the following:

> According to the Interpretation Act 33 of 1957 a month means a calendar month. In the absence of any clear indication to the contrary to be found in the words used in any particular legislation a calendar month running from an arbitrary date expires with the day in the succeeding month immediately preceding the day corresponding to the date upon which the period starts. Thus, if a calendar month commences on the 10th of one month it will expire at the end of the 9th day of the succeeding month.
>
> There are no clear indications in the context of section 10(1)(*o*)(ii) that the more restrictive meaning of a named calendar month was intended. The contextual factors in fact point the other way – the use of the word ‘any’ prior to the words ‘period of 12 months’ indicates that the meaning should be extended rather that restricted. (SARS, 2017: 6)

This means that the period of 12 months referred to in section 10(1)(*o*)(ii) of the Act must be given the more extended meaning and does not need to begin on the first day of a named calendar month or end on the last day of a named calendar month.

> The period or periods exceeding 183 full days mentioned above must fall within a period of 12 consecutive months. The period of 12 months is not necessarily a year of assessment, a financial year, or a calendar year; it is any period of 12 consecutive months. (SARS, 2017: 6)

A financial year in relation to an individual means 1 March to 28/29 February.

Apportionment of Remuneration

As discussed above and in Interpretation Note 16, only the foreign remuneration received or accrued to a taxpayer in respect of services rendered outside South Africa during the qualifying period of 12 months is exempt. Any other remuneration received or accrued by a taxpayer during a qualifying period of 12 months in respect of services rendered within the Republic remains subject to tax in South Africa. Once a person has met the 183-day and 60-continuous-day tests in terms of section 10(1)(*o*)(ii) of the Act, the portion of the remuneration that qualifies for the exemption under section 10(1)(*o*)(ii) must be determined

South Africa applied a source-based system of taxation prior to 2001 and then changed to a resident-based system of taxation. The change resulted in taxpayers being taxed on their worldwide income. Specifically, to South African tax residents employed overseas, their income could possibly be subject to double taxation. To avoid the double taxation of foreign income, relief is provided should the requirements of section 10(1)(*o*) be met, as analysed above.

CHAPTER 3: PROPOSED REPEAL AND ENACTED AMENDMENT OF FOREIGN INCOME EXEMPTION

National Treasury included the foreign income exemption into the Act to prevent the double taxation of foreign remuneration when South Africa changed from a sourced-based system of taxation to a resident-based system of taxation. In recent times, it has come to the attention of Government that the current foreign tax exemption creates opportunities for double non-taxation of foreign remuneration. This would occur when the foreign host county does not impose income tax on employment income or imposes taxes at a significantly reduced rate (National Treasury, 2017b).

In simpler terms, the double non-taxation of remuneration occurs when a resident taxpayer earns foreign remuneration for services rendered in a foreign country and the foreign country does not tax the remuneration of the taxpayer and the same remuneration is not taxable in the taxpayer's resident country. The opposite is true for the double taxation of remuneration. This means that foreign remuneration of resident taxpayer rendering service in a foreign country would be taxed in the foreign country and in their resident country.

To prevent the double non-taxation of remuneration and to prevent taxpayers from unfairly benefitting from this section of the Act, National Treasury proposed to repeal the foreign income exemption section 10(1)(*o*)(ii) from the Act.

National Treasury further stated that 'this exemption creates unequal tax treatment between South African residents employed by a national, provincial or local sphere of government or any public or municipal entity and South African residents employed by the private sector. This is because the former employees do not qualify for the exemption in respect of foreign employment income, whereas employees in the private sector do qualify for the income tax exemption in respect of foreign employment income' (National Treasury, 2017b).

In light of the above, National Treasury ‘proposed that the current section 10(1)(*o*)(ii) exemption be repealed. As a result, all South African tax residents will be subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under section 6*quat* of the Act’ (National Treasury, 2017b).

Will the abovementioned repeal prevent the double non-taxation of income? As mentioned previously, the foreign income exemption was inserted into the Act to prevent the double taxation of foreign remuneration, by repealing this section, is National Treasury allowing for the double taxation of foreign remuneration? Although relief may be provided as indicated by National Treasury in terms of section 6*quat*, which will be addressed in chapter 4, should the taxpayer not qualify for 6*quat*, the repeal of the foreign income exemption will result in the double taxation of foreign income.

This means that in the absence of any other relief, a South African resident taxpayer, who earns foreign remuneration for services rendered in a foreign country will be subject to tax on their remuneration in South Africa and in the foreign country.

The impact of double taxation could negatively impact the taxpayer, South Africa and the host country. ‘With such benefits becoming taxable in SA, the overall assignment cost to the assignee’s employer would increase, as such additional costs would be borne by the employer’ (Abbott, 2019). This may result in an adverse impact on the South African economy as a whole as the cost to employ a South African is now increased from an employer’s perspective.

Many other countries have a higher cost of living than South Africa. According to Peyper (2017), Kyle Mandy stated that, ‘most countries we’re dealing with here are far more expensive than South Africa, for example the UK and the UAE.’ This cost is usually built into the salary cost of an expatriate paid by the host country. If expatriates now have a higher tax liability, the host company would need to take this into consideration, resulting in a higher salary cost. According to Moneyweb (2017), Bertie Gouws said that the direct cost of the increased tax burden, which

will be borne by employers as a result of the repeal, is likely to have a significant impact on their bottom line.

The impact on current expatriates, as a result of the proposed repeal, will ultimately result in the taxpayer receiving less income after paying tax in South Africa and in the foreign country. Their normal cost of living would remain the same however they will have less income to manage their expenses. This would result in a reduced standard of living, an increased debt reliance to meet their expenses and reduced savings for retirement. Reduced savings for retirement could result on future reliance on the government for support reducing the government's ability to reallocate resources.

Should the taxpayer not be able to make ends meet, the expatriate may have to possible return to South Africa, without the possible guarantee of a job. In turn, this will increase the unemployment rate in South Africa, placing more reliance on the Government in terms of providing grants to the resident. Another consideration would be if the intention was for the taxpayer to render services in a foreign country to upskill and return to South Africa to upskill local resources, this may not be possible as the expatriate was not able to complete their traineeship by having to involuntary return to South Africa. This will again negatively impact the economy as South Africa would have lost the opportunity to have skilled resources and the ability to create employment.

For a South African wanting to become an expatriate, this may also be challenging as a result of the proposed repeal. Usually when an employee from the host country takes on an expatriate, that company will compensate the taxpayer for the expenditure to be incurred. This usually includes the tax burden of the taxpayer. Should the taxpayer not be subject to double taxation of income, this will be factored into the cost to company of the employer by the employee ultimately increasing their employee costs. This will have a negative impact on the company's net profit and may lead to foreign employers' reconsider employing South Africans specifically due to the additional cost. Taking the above into consideration, it would be more beneficial for the foreign host country to invest in a county, other than

South Africa, as their employee overhead cost will be lower considering that their employee cost will not include the additional tax burden and therefore the foreign country will still benefit from investing into a developing country.

As mentioned above, this will have a negative impact on the economy as skills development and enhancement of resources will not occur. The unemployment rate will increase in South Africa and the investment in skills development and knowledge will decrease. The benefits to the South African economy of having South African expatriates is the development of skilled labor, local job creation and the possibility of increased foreign investments into South Africa as a result of the improved resources.

The proposed repeal of the foreign income exemption will adversely impact South Africa and its residents. It may seem that the prevention of double non-taxation outweighs the development of skilled resources, investments into South Africa and employment.

After further consideration, Nation Treasury decided not to repeal the foreign income exemption section but rather to add in a limitation to the exemption to section 10(1)(*o*)(ii) that reads '*to the extent to which that remuneration does not exceed one million rand in respect of a year of assessment…'.* 'Effective as from 1 March 2020, the exemption will apply only to the extent to which the person's remuneration for services rendered outside South Africa does not exceed one million rand in respect of any year of assessment' (de Koker and Williams, 2018a).

According to le Cordeur (2017a), National Treasury said that the exemption threshold should reduce the impact of the amendment for lower to middle class South African tax residents who are earning remuneration abroad. This would be the case as the limitation to the exemption would not have an impact on expatriates earning less than a million rand, as their income would not be impacted. This would rather keep the lower to middle class in a neutral position instead of reducing the impact, as they would not actually be impacted.

On the basis that employees are remunerated based on the level of skill and knowledge, it would be assumed that the more skilled expatriates could possibly fall above the threshold. These taxpayers would be impacted, however the impacted will only apply to remuneration earned above the threshold.

CHAPTER 4: ALTERNATIVE OPTIONS TO PREVENT DOUBLE TAXATION OF FOREIGN INCOME

Evident from the amended act, National Treasury has not decided to repeal section 10(1)(*o*)(ii) of the Act but rather amend the section to add in a one million rand threshold to the exemption in aid of preventing the double non-taxation of income. This is an embedded option in the amended section 10(1)(*o*)(ii) of the Act for taxpayers who earn less than one million rand for foreign services rendered as an option to prevent the double taxation of foreign remuneration.

Taxpayers who earn more than this threshold may possibly still be exposed to the double taxation of foreign income and therefore options to prevent the double taxation of foreign income needs to be considered.

The following options may be available to taxpayers to prevent the double tax of foreign remuneration, which will be discussed in detail below:

- DTAs;
- Foreign tax rebates, more specifically section 6*quat* of the Act; and
- Change of tax residency.

Double Taxation Agreement

'A double tax agreement is an agreement or a contract regarding double taxation or, more correctly, the avoidance of double taxation' (ACCA, 2012).

'The purpose of the agreements between the two tax administrations of two countries is to enable the administrations to eliminate double taxation' (SARS, 2018a).

> Double taxation agreements ('DTAs') have played a relatively insignificant role in the case of most taxpayers, their importance was once again emphasised with the introduction of a residence based tax system in South Africa with effect from 1 January 2001.
>
> The reason for the foregoing is that a DTA, once properly approved and adopted, has the force of law and to that extent overrides the provisions of local South African fiscal legislation. In this context s108 of the Income Tax Act, 1962 ('the Act') provides that South Africa (the National Executive) may enter into DTAs with the governments of other

> countries whereby arrangements are made with those governments with a view to the prevention, mitigation or discontinuance of the levying of tax in respect of the same income, profits or gains under the laws of South Africa and of the other country concerned.
>
> The practical effect of the foregoing is that, even if tax is payable in South Africa in respect of particular income, profit or gains, South Africa will not be entitled to levy such tax to the extent that the provisions of a DTA prescribe that the relevant tax is not payable in South Africa or that only part thereof is payable. South African tax is thus not payable to the extent to which an exemption from tax is granted in terms of a DTA. (Edward Nathan & Friedland, 2001)

Therefore, should section 10(1)(*o*)(ii) be repealed or the taxpayer earning more than one million rand, the taxpayer could rely on a DTA which subjects the foreign income to be taxed in the taxpayer's host country or resident country. The DTA between South Africa and Australia and South Africa and the AUE will be consider in chapters 5 and 6.

<u>Foreign Tax Credits</u>

Section 6quat rebate

'Relief from double taxation resulting from the imposition of tax by a residence country and a source country on the same amount is normally granted by the residence country' (SARS, 2015). Therefore, the source country's right to tax generally has priority over the residence country's right to tax. In this instance, the source country would be the foreign host country and the resident country would be South Africa. In many instances, countries provide for relief from international juridical double taxation by way of a tax treaty, although many countries (including South Africa) also provide unilateral tax relief in their domestic law. In South Africa, this relief is provided in terms of section 6*quat*.

Section 6*quat* provides a special rebate, or unilateral tax credit, for foreign taxes payable by residents (natural persons and legal entities) in respect of income from non-Republic sources. Where a foreign country levies tax on income derived from a source in South Africa, in terms of the Act, section 6*quat* allows relief not as a rebate but in the form of a deduction for the foreign taxes paid.

A deduction is available when:

- Foreign taxes were imposed on South African sourced income; and
- The foreign tax is imposed in another country contrary to the tax treaty entered into between South African and the foreign country.

A section 6*quat* rebate is deductible from normal tax payable by a resident whose taxable income includes any income received by or accrued to a resident from any source outside South Africa.

> For purposes of clarity, the following is a summary of the legal nature of the income to qualify for the rebate:
>
> - The credit will operate only in respect of income which is from an actual source outside South Africa, or amounts not deemed to be from a source in South Africa. Where a tax is imposed on a South African resident in a foreign jurisdiction for services rendered, which the Commissioner considers to be from a South African source, a credit may not be claimed under section 6*quat*.
> - The amount received or accrued must be included in the taxpayer's taxable income, that is, it must not constitute exempt income.
> - The amount must have been subject to foreign tax; and the foreign tax must be 'proved to be payable. (de Koker and Williams, 2018b)

As indicated by de Koker and Williams (2018b), the amount of the rebate is equal to the sum of the foreign taxes on income proved to be payable to any sphere of government of any country other than South Africa, without any right of recovery by any person (other than a right of recovery in terms of an entitlement to carry back losses arising during any year of assessment to a prior year of assessment).

The rebate must be determined on the 'apportionment' or 'pro rata' basis which means that the maximum amount available as a rebate or rebates for any foreign tax proved to be payable is limited in aggregate to an amount that bears to the total normal tax payable the same ratio as the total taxable income attributable to the included income, proportional amount, taxable capital gain or amount bears to the total taxable income (s 6*quat*(1B)(*a*)). This approach is in accordance with the dictates of Interpretation Note 18 issued by SARS.

Expressed as a formula, the rebate will be calculated as follows:

Section 6*quat* rebate = (Resident's income subject to foreign tax (A)/ Resident's total taxable income from all sources (B)) × Total normal tax on B

Example 1: Rebate for foreign taxes on income (example adapted de Koker and Williams, 2018b: 17.22)

Background:

ABC Ltd received the following amounts during the 2018 year of assessment:

Gross foreign royalties (foreign tax of R1,000 paid)	R10,000
Gross Foreign interest (foreign tax of R5,600 paid)	R14,000
Other gross foreign income (foreign tax of R12,000 paid)	R30,000
Gross South African receipts	R114,000

All foreign taxes paid are not recoverable.

Calculate the foreign tax credit in terms of s 6*quat* and the normal tax payable of ABC Ltd for its year of assessment ended 28 February 2018.

Solution:

Foreign royalties	R10,000
Foreign interest	R14,000
Other foreign income	R30,000
South African receipts	R114,000
Taxable income	R168,000

Tax payable

Normal tax before rebates (28% of R168,000)	R47,040
Less: Section 6*quat* rebate (see calculation below)	(R15,120)
Normal tax payable	R31,920

Calculation of the s 6quat rebate

(Foreign taxable income / Taxable income) × Normal tax payable before rebates

= R54,000 (note 1) / R168,000 × R47,040

= R15,120

Note 1: The R54,000 is calculated as (R10,000 + R14,000 + R30,000)

Even though the actual foreign tax of R18,600 (R1,000 + R5,600 + R12,000) exceeds the calculated R15,120, the section 6*quat* rebate is limited to R15,120 in terms of section 6*quat* (1B)(*a*).

The excess of the foreign tax which was not allowed as section 6*quat* rebate (the 'excess amount'), i.e. R3,480 (R18,600 less R15,120), may be carried forward for a maximum period of seven years to be set off against normal tax (proviso (iii) to section 6*quat* (1B)(*a*).

de Koker and Williams (2018b) discuss that since the taxable income attributable to the included income (that is, the total taxable income from all foreign countries) must be aggregated, as must the normal tax payable on this income, for the purposes of calculating the rebate, it is clear that the rebate is not 'ring-fenced' relative to each foreign country. Instead it is calculated on what can be described as a 'pooled basis', which means that there is no need to link each amount of foreign tax to a specific amount of income.

Section 6quat deduction

A South African resident may elect to deduct from the income so derived the sum of any foreign taxes payable, where a South African resident is subject to tax in a foreign country, but the originating cause (or source) of the activities giving rise to the income received is in South Africa.

> 'The deduction will be an amount equal to the sum of the foreign taxes on income paid or proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person other than a right of recovery other than in terms of an international tax agreement or in terms of any entitlement to carry back losses arising during any year of assessment to any year prior to such year of assessment (s 6*quat*(1C)). (de Koker and Williams, 2018b: 17.22)

For the purposes of this report, the section 6*quat* deduction will not be applicable as the 'origination cause (or source) of the activities giving rise to the income received' is not South Africa, but rather the foreign country.

> The section 6*quat* rebate or deduction is granted in substitution for the relief to which a resident would be entitled under a double taxation agreement, and not in addition to such relief (section 6*quat*(2)). That is, either the section 6*quat* rebate or the tax treaty rebate will apply, but not both. The election is the prerogative of the taxpayer, not SARS. This view is fortified by Interpretation Note 18, which makes it clear that 'a resident [may] choose between the relief provided in the DTA and the relief provided under section 6*quat*'. This choice may be exercised annually and the resident is not bound by a choice made in previous years of assessment. If no option is elected by the resident, SARS, in practice, applies section 6*quat*. (de Koker and Williams, 2018b: 17.22)

Change of Tax Residency

South Africa has a residence-based tax system, which means that South African residents are taxed on their worldwide income irrespective of where their income was earned, subject to certain exclusions. Opposed to South African tax residents who are taxed on their worldwide income, non-residents are taxed on their income from a South African source. Examples of interest from a South African source includes interest on capital invested in a local bank or rental income generated from a fixed property situated in South Africa.

As discussed in chapter 2, section 10(1)(*o*)(ii) is applicable to South African tax residents who earned foreign sourced income. For this section not to be applicable and hence to avoid the double taxation of the foreign sourced income, a South African tax resident could change their tax residency status from that of South African to that of the foreign, or rather, host country.

As indicated by Hughes and Crocker (2018), a person's tax residency status will change based on a conscious decision to change your country of ordinary residence, but may also change based on the application of the rules of a Treaty for the Avoidance of Double Taxation between South Africa and another country. There is no specific form for a taxpayer to complete to request a change of tax status.

When a taxpayer makes the conscious decision to change their tax residency, the day before an individual becomes a non-resident for tax purposes, they are deemed to dispose of their worldwide asset base at market value on that day. Hughes and Crocker (2018) further indicate that this deem disposal will trigger a capital gain or loss that must be declared to SARS, with the potential corresponding tax liability. There is an exclusion to this exposure, limited to fixed property situated in South Africa.

Section 9H of the Act, determines that when a person ceases to be tax resident in South Africa, that person is deemed to have disposed of all his or her assets on the day before that the individual emigrates for income tax purposes. In other words, when calculating the income tax exposure of a South African taxpayer who changed his tax residency status, individuals emigrating for tax purposes are regarded as having sold all of their assets at market value on the day before that on which they leave the country. As mentioned above, a capital gain is realised on this deemed disposal that is subject to CGT at the prevailing tax rates.

As discussed on Succeedblog (2017), the policy for taxing individuals upon emigration is justified in the sense that taxes are to be levied on all capital growth achieved on assets owned by South African residents while they were tax resident. Once an individual will have emigrated, limited mechanisms would exist whereby capital gains may only be realised upon eventual actual sale of assets subsequently once the individuals are no longer tax resident in South Africa. It is for this reason that South African immovable property is excluded from the ‘exit charges’ regime; section 35A of the Income Tax Act provides for a withholding tax mechanism whereby CGT may be recovered from non-residents when they sell South African immovable property.

It should be considered that even though the decision to cease to be a tax resident has been made and the taxpayer is no longer a South African tax resident, a taxpayer could still be considered to be a South African tax resident.

In terms of the South African law, there are different types of residents. For example, a resident defined by the Act in terms of the so-called ‘physical presence test’ and an ordinary resident defined in terms of South African common law.

The common law concept of a resident means any individual who is ordinarily resident in South Africa during the year of assessment or, failing which, meets all three requirements of the physical presence test, will be regarded as a resident for tax purposes.

As ordinarily resident is not defined on South African law, reference is made to case law. As per the *Cohen* case, an individual will be considered to be ordinarily resident in South Africa, if South Africa is the country to which that individual will naturally and as a matter of course return after his or her wanderings. It could be described as that individual's usual or principal residence, or his or her real home as per the *Kuttel* case. If an individual is not ordinarily resident in South Africa, he or she may still meet the requirements of the physical presence test and will be deemed to be a resident for tax purposes.

For an individual to be physically present in South Africa, an individual must meet the requirements of the physical presence test which requires an individual to be physical present in South Africa for a period or periods exceeding:

- 91 days in total during the year of assessment under consideration;
- 91 days in total during each of the five years of assessment preceding the year of assessment under consideration; and
- 915 days in total during those five preceding years of assessment.

An individual who fails to meet any one of these three requirements will not satisfy the physical presence test. In addition, any individual who meets the physical presence test, but is outside South Africa for a continuous period of at least 330 full days, will not be regarded as a resident from the day on which that individual ceased to be physically present.

As per SARS (2018a), if the individual is neither ordinarily resident, nor meets the requirements of the physical presence test, that individual will be regarded as a

non-resident for tax purposes. This means that individual will be subject to tax only on income that has its source in South Africa, for example, interest earned from a South African Bank; rental income earned from a property in South Africa; and services rendered in South Africa.

DTAs, foreign tax rebates and change of tax residency are options available to taxpayers to avoid the double taxation of foreign sourced income which has been discussed above. The practical application will be discussed in chapters 5 and 6.

CHAPTER 5: IMPACT OF THE PROPOSED REPEAL AND ENACTED AMENDMENT ON SOUTH AFRICAN EXPATRIATES RESIDING IN UNITED ARAB EMIRATES

The impact of the proposed repeal of section 10(1)(*o*)(ii) of the Act and the enacted amendment by the insertion of the one million rand threshold on South African expatriates residing in the UAE will now be assessed through illustrative examples. The example will assume that the taxpayer earns more than one million rand, to assess the impact of the proposed repeal of section 10(1)(*o*)(ii) and the enacted amendment to this section.

This example will consider the alternative options to prevent double taxation of foreign income as discussed in chapter 4, but more specifically to South African expatriates residing in the UAE.

The UAE has been selected as a comparative country as no income tax is levied in this country and the UAE has a DTA with South Africa. Further, according to Tom Head (2017) the UAE is ranked as the third county where South Africans are living abroad. The UAE therefore meets the criteria to assess whether the proposed repeal will prevent the double non-taxation of foreign income.

A standard example will be used and a sensitivity analysis be performed by applying the different preventions of double taxations methods being the use of a DTA, the application of section 6*quat* of the Act and the change of the tax residency of the taxpayer.

To test the effects of the proposed repeal to section 10(1)(*o*)(ii), the basis of the analysis will be a tax liability computation of a South African tax resident residing in the UAE should this section not be repealed. Comparative tax computation will be performed considering the proposed repeal and the alternative options to prevent the double taxation of the foreign income.

Tax computation with section 10(1)(*o*)(ii)

Background Facts

For the purposes of the comparative study the following facts of the taxpayer will be assumed. Mr Smith is a South African tax resident, who works in the UAE. He is 35 years old and receives foreign remuneration for services rendered in the UAE of the equivalent of R2 million per annum. Mr Smith has rental property in South Africa and earns rental income of R120,000 and incurs deductible expenses of R30,000 per annum in South Africa on the property. Mr Smith acquired the property in 2015 for R800,000 and the property's market value at 28 February 2018 is R1 million.

Tax liabilities will be calculated for Mr Smith for the 2018 year of assessments. For the purposes of these computations, it will be assumed that the requirements of section (10)(1)(*o*)(ii) of the Act have been met (before or after the amendments to the Act depending on the scenario).

Further, as the DTA may take precedence over the Act, for the purposes of this scenario it is assumed that the DTA is not applicable to each scenario unless specifically stated

Tax computation 1: UAE tax liability

The exchange rate between the UAE and South Africa is 1 United Arab Emirates Dirham to 4 South African Rands. Therefore, Mr Smith earned AED500,000. As there in no income tax in the AUE, Mr Smith's tax liability in the AUE is AED0.

		AED
Gross income	R2,000,000/4	500,000
Taxable income		500,000
Tax rate: 0%		0%
Tax liability	AED500,000*0%	0

Tax computation 2: no amendment to section 10(1)(*o*)(ii)

This tax computation will analyse Mr Smith's tax liability in South Africa before any proposed repeal to section 10(1)(*o*)(ii) of the Act.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-2,000,000
Income		120,000
Less: deductions		
Rental expense		-30,000
Taxable income		90,000
Tax liability per Table 1	90,000*18%	16,200
Primary rebate		-13,635
Tax liability		2,565

Based on the above tax computation, section 10(1)(*o*)(ii) was applied, as if the section was not repealed or amended, and the total foreign remuneration earned by Mr Smith of R2 million was exempted. As a result, Mr Smith was only taxed on his South African income which resulted in a South African tax liability of R2,565.

Tax computation 3: proposed repeal to section 10(1)(*o*)(ii)

This tax computation will analyse Mr Smith's tax liability should the proposed repeal to section 10(1)(*o*)(ii) be implemented and this section repealed in its entirety.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)	Repealed	-
Income		2,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		2,090,000
Tax liability per Table 1	((2,090,000-1,500,000)*45%)+533,625	799,125
Primary rebate		-13,635
Tax liability		785,490

Should the proposed repeal of the entire section 10(1)(*o*)(ii) be enacted, from the above tax computation, Mr Smith's taxable income will be R785,490.

<u>Tax computation 4: amendment to section 10(1)(*o*)(ii)</u>

This tax computation will analyse Mr Smith's tax liability based on the amended section 10(1)(*o*)(ii). The amended section allows for the first million rand of foreign remuneration received to be exempt from tax.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-1,000,000
Income		1,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		1,090,000
Tax liability per Table 1	((1,090,000-708,310)*41%)+209,032	365,525
Primary rebate		-13,635
Tax liability		351,890

Based on the amended section 10(1)(*o*)(ii), Mr Smith will be liable for tax of R351,890 as indicated in the above tax computation.

<u>Tax computation 5: proposed repeal to section 10(1)(*o*)(ii) considering the application of the DTA</u>

This tax computation will be based on the proposed repeal of section 10(1)(*o*)(ii) and consider the DTA between South Africa and the UAE. Consideration will be made to Article 14 'Income from employment' of the DTA between South Africa and the UAE which states:

> 1. Subject to the provisions of Articles 15, 17 and 18, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
>
> 2. Notwithstanding the provisions of paragraph 1 of this Article, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
>
> (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
>
> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
>
> (c) the remuneration is not borne by a permanent establishment which the employer has in the other State (South Africa, 1999).

In paragraph 1 above, the terms 'Contracting State' refers to South Africa and 'other Contracting State' means the AUE. Applying this paragraph to the scenario, the remuneration earned by Mr Smith, a South African tax resident, in respect of an employment shall only be taxed in South Africa unless the employment is exercised in the AUE, which is the case. Therefore, the remuneration may be taxed in the AUE. It must be noted that this paragraph does not state that the remuneration will not be stated in South Africa, therefore paragraph 2 should be considered.

Paragraph 2 goes on to state that notwithstanding the provisions of paragraph 1, remuneration derived by Mr Smith, a South African tax resident, in respect of an employment exercised in the UAE will be taxable only in South Africa if

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

As stated in the background facts, Mr Smith met the requirements of section 10(1)(*o*)(ii) which requires him to be outside of South Africa for a period exceeding 183 days, therefore requirement (a) above is not met. As paragraph 2 contains an 'and' requirement and first requirement (a) is not met, it is not necessary to consider the remaining requirements.

Therefore, as these requirements are not met, Mr Smith's foreign remuneration will not be taxable in South Africa and only taxable in the AUE.

Should Mr Smith apply the DTA between South Africa and the AUE, his tax liability will be R2,565 as per the tax computation below.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Application of DTA		-2,000,000
Income		120,000
Less: deductions		
Rental expense		-30,000
Taxable income		90,000
Tax liability per Table 1	90,000*18%	16,200
Primary rebate		-13,635
Tax liability		2,565

<u>Tax computation 6: proposed repeal to section 10(1)(*o*)(ii) considering the application of foreign tax credits</u>

As discussed in chapter 4, the section 6*quat* rebate is available to taxpayers who earned foreign remuneration for services rendered in a foreign country which was subject to tax. Specifically, to Mr Smith who earned foreign remuneration from the AUE, his foreign remuneration was not subject to tax in the UAE as the UAE does not have personal income tax. Therefore, Mr Smith does not qualify for a section 6*quat* rebate.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)	Repealed	-
Income		2,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		2,090,000
Tax liability per Table 1	((2,090,000-1,500,000)*45%)+533,625	799,125
Primary rebate		-13,635
Section 6*quat* rebate		-
Tax liability		785,490

As per the tax computation above, Mr Smith's South African tax liability will be R785,490 if section 10(1)(*o*)(ii) was repealed and section 6*quat* applied.

<u>Tax computation 7: proposed repeal to section 10(1)(*o*)(ii) considering the change of tax residency</u>

As discussed in chapter 4, when a taxpayer makes a conscious decision to change their tax residency, the taxpayer is deemed to have disposed of their assets the day before the taxpayer leaves the country.

Per the example Mr Smith, only owns rental property which he acquired in 2015 for R800,000. In terms of section 9H(4)(*a*) of the Act, 'subsections (2) and (3) do not apply in respect of an asset of a person where that asset constitutes (a) immovable property situated in the Republic that is held by that person'. Mr Smith is deemed to dispose of this asset in South Africa, other than his immovable property.

This rental property is considered immovable property and therefore the deemed disposal would not apply when Mr Smith ceases to be a resident.

For the purposes of this example it is assumed that Mr Smith ceases to be a resident effective 28 February 2017. ‘If a person ordinarily resident moves permanently from the Republic, for example, if he emigrates or if he leaves permanently but without formally emigrating, he is no longer ordinarily resident from the date of his departure’ (de Koker and Williams 2018b: §14.37). The foreign remuneration earned by Mr Smith will not be included in Mr Smith’s taxable income for South African tax purposes. If Mr Smith changed his tax residency during the tax year, his primary resident exemption would be apportioned for the period Mr Smith was a South African tax resident.

However, the income earned by Mr Smith from a source within South Africa should be included in Mr Smith’s taxable income for South African tax purposes in terms of section 9 of the Act.

		Rand
Gross income		
Foreign remuneration	Not taxed on worldwide income (effective from emigration)	-
Rental income	Taxed on sourced income	120,000
Net gross income		120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-
Income		120,000
Less: deductions		
Rental expense		-30,000
Taxable income before capital gains tax		90,000
Capital Gain Tax	Exit charge not applicable (s9H(4)(*a*))	-
Taxable income		90,000
Tax liability per Table 1	(90,000*18%)	49,809
Primary rebate		-13,635
Section 6*quat* rebate		-
Tax liability		2,565

As per the above tax computation, should Mr Smith change his tax residency and no longer be a South African taxpayer, his South African tax liability for the year would be R2,565.

Tax computation summary

In this chapter, the practical application of the proposed repeal to section 10(1)(*o*)(ii) and the alternative options available to prevent the double taxation of foreign remuneration from a South African tax resident earning foreign remuneration from the UAE will be analysed.

The table below summarises the tax liability per option detailed above.

Tax computation	**Tax liability**
Tax computation 1: UAE tax liability	AED 0
Tax computation 2: no amendment to section 10(1)(*o*)(ii)	R 2,565
Tax computation 3: proposed repeal to section 10(1)(*o*)(ii)	R 785,490
Tax computation 4: amendment to section 10(1)(*o*)(ii)	R 351,890
Tax computation 5: proposed repeal to section 10(1)(*o*)(ii) considering the application of the DTA	R 2,565
Tax computation 6: proposed repeal to section 10(1)(*o*)(ii) considering the application of foreign tax credits	R 785,490
Tax computation 7: proposed repeal to section 10(1)(*o*)(ii) considering the change of tax residency	R 2,565

Mr Smith paid no tax in the UAE on his remuneration earned in the UAE. Should section 10(1)(*o*)(ii) not be repealed or amended, Mr Smith's South African tax liability would be R2,565. This tax liability is as a result of Mr Smith's South African income only. Therefore, Mr Smith's foreign remuneration is not taxable as a result of section 10(1)(*o*)(ii). As this foreign remuneration is not taxed in the UAE or in South Africa, this income is subject to double non-taxation. It is because of this reason, section 10(1)(*o*)(ii) was proposed to be repealed. It should however be noted that this is the optimal tax position for Mr Smith.

Should this section be repealed and Mr Smith not apply a method to reduce his South African tax liability, Mr Smith's tax liability would be R785,490 which is the worst position for him to be in. Mr Smith's foreign remuneration will only be subject to tax in South Africa and not taxed in the UAE, this income would be subject to taxation in at least one country, therefore the double taxation or double non-taxation of income would not be applicable. This is an indication that National

Treasury's purpose to prevent the double non-taxation of income has been achieved.

Although National Treasury's objective has been achieved, the proposed repeal does not allow for Mr Smith to be in his optimal tax position, his South African tax liability would significantly increase and may result in further adverse consequences as discussed in chapter 3. Mr Smith would need to apply an option to reduce his South African tax liability.

National Treasury is aware that the proposed repeal to section 10(1)(*o*)(ii) may result in adverse tax consequences for the expatriate, and after taking into consideration public comment, decided to rather amend this section to include the one million rand threshold than to repeal this section. Applying the amended section 10(1)(*o*)(ii), Mr Smith's South African tax liability would be R351,890, which puts him in a worse position if this section was not repealed but in a better position if this section was amended. This amendment would achieve National Treasury's purpose to prevent the double non-taxation of income, but will still increase Mr Smith's South African tax liability significantly.

Should Mr Smith apply the foreign tax rebate, his South African tax liability would be R785,490, as the section 6*quat* rebate is not available to Mr Smith as no foreign tax was paid.

Should Mr Smith change his tax residency, with effect from the 2018 year of assessment, from South Africa to the UAE, his South African tax liability would be R2,565. This again is Mr Smith's optimal tax position. It should however be noted that as this foreign remuneration was not taxed in South Africa, the option for Mr Smith to change is tax residency status from South Africa to the UAE results in the double non-taxation of the UAE income.

Should Mr Smith remain a South African taxpayer and rely on the DTA between South Africa and the UAE his South African tax liability would be R2,565, which again is his optimal tax position. The reliance on the DTA results in Mr Smith's foreign remuneration not been taxed in South Africa.

It should be noted that in the situation where Mr Smith's South African tax liability is optimised, such as when section (10)(1)(*o*)(ii) is not repealed or amended, the DTA is applied and Mr Smith Tax residency is changed, the foreign remuneration earned by Mr Smith is not subject to tax in South Africa or in the UAE and therefore, these options, result in the double non-taxation of foreign remuneration. National Treasury's purpose to repeal the section is not met in these instances, as the purpose to prevent the double non-taxation of foreign income has not been prevented.

From the above practical examples, the best method for a South African tax resident who earns foreign remuneration from the UAE would be to rely on the DTA between South Africa and the UAE to reduce their tax liability if section (10)(1)(*o*)(ii) be repealed or amended.

This outcome is specific to South African taxpayers residing in the UAE. It should be noted that other countries with whom South Africa has a DTA with may not necessarily result in the same tax consequences as discussed in the examples above due to the specific wording to the DTAs with South Africa and other countries. Although National Treasury's objective to prevent the double non-taxation of income was not met in this scenario, it does not mean their objective amendment to section 10(1)(*o*)(ii) to prevent the double non-taxation of income would not be met in its entirety.

CHAPTER 6: IMPACT OF THE PROPOSED REPEAL AND ENACTED AMENDMENT ON SOUTH AFRICAN EXPATRIATES RESIDING IN AUSTRALIA

The impact of the proposed repeal of section 10(1)(*o*)(ii) of the Act and the enacted amendment by the insertion of the one million rand threshold on South African expatriates residing in Australia will now be assessed through illustrative examples. As mentioned in chapter 5, the example will assume that the taxpayer earns more than one million rand, to assess the impact of the proposed repeal of section 10(1)(*o*)(ii) and the enacted amendment to this section.

This example will consider the alternative options to prevent double taxation of foreign income as discussed in chapter 4, but more specifically to South African expatriates earning foreign remuneration from Australia.

Australia has been selected as best suited to form part of the study because Australia and South Africa have a DTA and the tax rate in Australia is similar to that of South Africa. Australia meets the requirements to assess whether the proposed repeal results in double taxation of foreign income. Other countries meet these requirements as well, however, according to Tom Head (2017), Australia is ranked as the second country where South Africans are living abroad, whereas the United Kingdom is ranked first. As stated by Businestech (2018),

> According to StatsSA's Community Survey 2016, approximately 102,793 people left the country in the 10 years from 2006 to 2016. The highest proportion of emigrants moved to Australia at 26.0% followed by United Kingdom and United States at 25.0% and 13.4% respectively.

Therefore, Australia is best suited for the study.

A standard example will be used and a sensitivity analysis be performed by applying the different prevention of double taxations methods being the use of a DTA, the application of section 6*quat* of the Act and the change of the tax residency of the taxpayer.

To test the effects of the proposed repeal to section 10(1)(*o*)(ii), the basis of the analysis will be a tax liability computation of a South African tax resident residing in Australia should this section not be repealed. Comparative tax computation will be performed considering the proposed repeal and the alternative options to prevent the double taxation of the foreign income.

Tax computation with section 10(1)(*o*)(ii)

Background Facts

For purposes of the comparative study, the background fact will be similar to that used in chapter 5. This will allow for a further comparison between South African tax residents earning foreign remuneration in Australia and South African tax residents earning foreign remuneration in the UAE.

The example will assume the following facts of the taxpayer. Mr Smith is a South African tax resident who works in Australia. He is 35 years old and receives foreign remuneration for services rendered in Australia being the equivalent of R2 million per annum. Mr Smith has rental property in South Africa and earns rental income of R120,000 and incurs deductible expenses of R30,000 per annum. Mr Smith acquired the property in 2015 for R800,000 and the property's market value at 28 February 2018 is R1 million.

Tax liabilities will be calculated for Mr Smith for the 2018 year of assessment. For the purposes of these computations, it will be assumed that the requirements of section (10)(1)(*o*)(ii) of the Act have been met (before or after the amendments to the Act depending on the scenario).

Further, as the DTA takes precedence over the Act, for the purposes of this scenario it is assumed that the DTA is not applicable to each scenario unless specifically stated**.**

Tax computation 8: Australian tax liability as a non-resident

The exchange rate between Australia and South Africa is 1 Australian Dollar to 10 South African Rands. Therefore, Mr Smith earned AUD 200,000.

As per The Australian Expatriate's Gateway (Exfin.com, 2019), Australia has different Individual Income Tax rate for Australian residents and non-residents.

Mr Smith is a South African tax resident and therefore the non-resident individual tax rates of Australia would be applicable to the remuneration earned by him from Australia. After applying the relevant tax rates, Mr Smith's tax liability in Australia is AUD 71,685.

		AUD
Gross income	R2,000,000/10	200,000
Taxable income		200,000
Tax liability per Table 2	((200,000-180,000*45%)+62,6985	71,685

Tax computation 9: no amendment to section 10(1)(*o*)(ii)

This tax computation will analyse Mr Smith's tax liability in South Africa based on no proposed repeal or enacted amendment of section 10(1)(*o*)(ii) of the Act.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-2,000,000
Income		120,000
Less: deductions		
Rental expense		-30,000
Taxable income		90,000
Tax liability per Table 1	90,000*18%	16,200
Primary rebate		-13,635
Tax liability		2,565

Based on the above tax computation, section 10(1)(*o*)(ii) was applied and the total foreign remuneration earned by Mr Smith of R2 million was exempt. As a result, Mr Smith was only taxed on his South African income which resulted in a South African tax liability of R2,565. Mr Smith's tax liability in Australia is AUD 71,685.

Tax computation 10: proposed repeal to section 10(1)(*o*)(ii)

This tax computation will analyse Mr Smith's tax liability should the propose repeal to section 10(1)(*o*)(ii) be implemented and this section repealed.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)	Repealed	-
Income		2,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		2,090,000
Tax liability per Table 1	((2,090,000-1,500,000)*45%)+533,625	799,125
Primary rebate		-13,635
Tax liability		785,490

Should the proposed repeal of section 10(1)(*o*)(ii) be enacted, from the above tax computation, Mr Smith's South African tax liability will be R785,490. Mr Smith's tax liability in Australia is AUD 71,685.

Tax computation 11: amendment to section 10(1)(*o*)(ii)

This tax computation will analyse Mr Smith's tax liability based on the amended section 10(1)(*o*)(ii). The amended section allows for the first million rand of foreign remuneration received to be exempt from tax.

	Rand
Gross income	
Foreign remuneration	2,000,000
Rental income	120,000

Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-1,000,000
Income		1,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		1,090,000
Tax liability per Table 1	((1,090,000-708,310)*41%)+209,032	365,525
Primary rebate		-13,635
Tax liability		351,890

Based on the amended section 10(1)(*o*)(ii), Mr Smith will be liable for tax of R351,890 as indicated in the above tax computation. Mr Smith's tax liability in Australia is AUD 71,685.

<u>Tax computation 12: proposed repeal to section 10(1)(*o*)(ii) considering the application of the DTA</u>

This tax computation will be based on the proposed repeal of section 10(1)(*o*)(ii) and consider the DTA between South Africa and Australia. Consideration will be made to Article 23 Methods of Elimination of Double Taxation and Article 15 Dependent Personal Services of the DTA between South Africa and Australia.

Article 23 states,

> 1. Subject to the provisions of the law of Australia from time to time in force which relate to the allowance of a credit against Australian tax of tax paid in a country outside Australia (which shall not affect the general principle of this Article), South African tax paid under the law of South Africa and in accordance with this Agreement, whether directly or by deduction, in respect of income derived by a person who is a resident of Australia from sources in South Africa shall be allowed as a credit against Australian tax payable in respect of that income.
>
> 2. Where a company which is a resident of South Africa and is not a resident of Australia for the purposes of Australian tax pays a dividend to a company which is a resident of Australia and which controls directly or indirectly not less than 10 per cent of the voting power of the first mentioned company, the credit referred to in paragraph 1 shall include the South African tax paid by that first mentioned company in respect of that portion of its profits out of which the dividend is paid.
>
> 3. In the case of South Africa, Australian tax paid by a resident of South Africa in respect of income taxable in Australia in accordance with the Agreement, shall be deducted from the

> taxes due according to South African fiscal law. The deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income.

Applying this DTA to the example, paragraph 1 of Article 23 will not be applicable as Mr Smith is considered a tax resident of South Africa. Further paragraph 2 of Article 23 would not be applicable as it deals with a company and Mr Smith is an individual. Therefore, paragraph 3 of Article 23 is available to Mr Smith to reduce his taxable income.

Article 15 states,

> 1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by an individual who is a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived from that exercise may be taxed in that other State.
>
> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by an individual who is a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first mentioned State if:
>
> (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any 12 month period commencing or ending in the year of income or year of assessment of that other State; and
>
> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other State; and
>
> (c) the remuneration is not deductible in determining taxable profits of a permanent establishment or a fixed base which the employer has in that other State.
>
> 3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State may be taxed in that State.

Paragraph 1 of Article 15 implies that remuneration earned by a South African tax resident, for services performed in Australia should be taxed in Australia only, if the requirements of Article 15, paragraph 2 are met. Paragraph 2 echo the requirements of section 10(1)(*o*)(ii) of the Act. Specific to this example, paragraph 3 would not be applicable as the services render were not exercised aboard a ship or aircraft.

Should Mr Smith apply the DTA between South Africa and Australia, his South African tax liability before applying the DTA of R785,490 will be reduced by the tax

paid in Australia of AUD71,685 which translates to R716,850 resulting in a tax liability in South Africa of R68,640 as per the tax computation below. Mr Smith's tax liability in Australia is AUD71,685.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)	Repealed	-
Income		2,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		2,090,000
Tax liability per Table 1	((2,090,000-1,500,000)*45%)+533,625	799,125
Primary rebate		-13,635
South African Tax liability before DTA		785,490
Application of DTA: Less Australian tax		-716,850
Tax liability		68,640

Tax computation 13: proposed repeal to section 10(1)(*o*)(ii) considering the application of foreign tax credits (s 6*quat*)

As discussed in chapter 4, a section 6*quat* rebate is available to taxpayers who earned foreign remuneration for services rendered in a foreign country which was subject to tax. As Australia has income tax on remuneration earned by non-residents, Mr Smith's foreign remuneration is subject to tax in Australia. Therefore, Mr Smith will qualify for a section 6*quat* rebate.

		Rand
Gross income		
Foreign remuneration		2,000,000
Rental income		120,000
Net gross income		2,120,000
Less: exempt income		
Section 10(1)(*o*)(ii)	Repealed	-
Income		2,120,000
Less: deductions		
Rental expense		-30,000
Taxable income		2,090,000

Tax liability per Table 1	((2,090,000-1,500,000)*45%)+533,625	799,125
Primary rebate		-13,635
Section 6*quat* rebate		-764,713
Tax liability		20,777

Section 6quat rebate calculation

$$\frac{\text{Foreign Taxable income}}{\text{Taxable income}} \times \text{Normal tax payable before rebate}$$

$$\frac{2,000,000}{2,090,000} \times 799,125$$

= 764,713

As per the tax computation above, Mr Smith's South African tax liability will be R20,777 if section 10(1)(*o*)(ii) was repealed and section 6*quat* applied. Mr Smith's tax liability in Australia is AUD 71,685.

Tax computation 14: proposed repeal to section 10(1)(*o*)(ii) considering the change of tax residency

As discussed in chapter 4, when a taxpayer makes a conscious decision to change their tax residency, the taxpayer is deemed to have disposed of their assets the day before the taxpayer leaves the country. When a taxpayer changes their tax residency, the tax tables of the country should be applied. In this scenario, taxpayer would need to apply the Australian resident tax tables.

Per the example Mr Smith, only owns rental property which he acquired in 2015 for R800,000. In terms of section 9H(4)(*a*) of the Act, 'subsections (2) and (3) do not apply in respect of an asset of a person where that asset constitutes (a) immovable property situated in the Republic that is held by that person'. Mr Smith is deemed to dispose of this asset in South Africa, other than his immovable property.

This rental property is considered immovable property and therefore the deemed disposal would not apply when Mr Smith ceases to be a resident.

As Mr Smith has changed his tax residency, for the purposes of this example it is assumed that Mr Smith ceases to be a resident effective 28 February 2017. 'If a person ordinarily resident moves permanently from the Republic, for example, if he emigrates or if he leaves permanently but without formally emigrating, he is no longer ordinarily resident from the date of his departure' (de Koker and Williams 2018b: section 4.37). The foreign remuneration earned by Mr Smith will not be included in Mr Smith's taxable income for South African tax purposes. If Mr Smith changed his tax residency during the tax year, his primary resident exemption would be apportioned for the period Mr Smith was a South African tax resident.

However, the income earned by Mr Smith from a source within South Africa should be included in Mr Smith's taxable income for South African tax purposes in terms of section 9 of the Act.

		Rand
Gross income		
Foreign remuneration	Not taxed on worldwide income (effective from emigration)	-
Rental income	Taxed on sourced income	120,000
Net gross income		120,000
Less: exempt income		
Section 10(1)(*o*)(ii)		-
Income		120,000
Less: deductions		
Rental expense		-30,000
Taxable income before capital gains tax		90,000
Capital Gain Tax	Exit charge not applicable (s9H(4)(a))	-
Taxable income		90,000
Tax liability per Table 1	90,000*18%	16,200
Primary rebate		-13,635
Section 6*quat* rebate		-
Tax liability		2,565

As per the above tax computation, should Mr Smith change his tax residency and no longer be a South African taxpayer, his South African tax liability for the year would be R2,565.

Mr Smith's Australian remuneration will also be taxed in Australia, however, As Mr Smith is now an Australian tax resident, the Australian resident tax tables would be applicable. Mr Smith's tax liability in Australia is AUD 71,685.

<u>Tax computation 15: Australian tax liability as an Australian resident</u>

		AUD
Australian income	R2,000,000/10	200,000
Worldwide income	R90,000/10	9,000
Gross income		209,000
Article 6 of DTA		-9,000
Taxable income		200,000
Tax liability per Table 3	((200,000-180,000)*45%)+54232	63,232

Therefore, to assess his total tax liability for the year his South African tax liability should be added to his Australian tax liability.

From an Australian perspective, as Mr Smith is no longer a South African tax resident but an Australian tax resident, the tax table of an Australian resident taxpayer should be applied. Further consideration would need to be given if Mr Smith would be taxed on his worldwide income from an Australian perspective and whether a possible exemption may be applicable in terms of the DTA between South Africa and Australia and the Australian Tax Act.

As per the Australian Taxation Office (2019), Australian residents are generally taxed on their worldwide income from all sources. Mr Smith's rental income from South Africa would therefore be included in determining his Australian tax liability.

As this rental income would be taxed in South Africa, as it is sourced from South Africa and now in Australia, the rental income would be subject to double taxation. To prevent the double taxation of this rental income, Mr Smith would apply the DTA between Australia and South Africa to relief the double taxation of rental income.

In term of Article 6 of the DTA between South Africa and Australia:

> 1. Income from real property may be taxed in the Contracting State in which the real property is situated.
>
> 2. In this Article, the term ‘real property’:
>
> (a) in the case of Australia, has the meaning which it has under the law of Australia and includes:
>
> (i) a lease of land and any other interest in or over land, whether improved or not, including a right to explore for mineral, oil or gas deposits or other natural resources, and a right to mine those deposits or resources; and
>
> (ii) a right to receive variable or fixed payments either as consideration for or in respect of the exploitation of, or the right to explore for or exploit, mineral, oil or gas deposits, quarries or other places of extraction or exploitation of natural resources; and
>
> (b) in the case of South Africa, means such property which according to the law of South Africa is immovable property, and includes:
>
> (i) property accessory to immovable property;
>
> (ii) rights to which the provisions of general law respecting landed property apply;
>
> (iii) usufruct of immovable property; and
>
> (iv) a right to receive variable or fixed payments either as consideration for or in respect of the exploitation of, or the right to explore for or exploit, mineral, oil or gas deposits, quarries or other places of extraction or exploitation of natural resources.

Per Article 6, rental income may be taxed in the country in which the property is situated. Therefore, in this scenario the rental income received by Mr Smith will only be taxable in South Africa and not in Australia.

As the foreign rental income earned by Mr Smith, now as an Australian tax resident is exempt in terms of the DTA, it is not necessary to further investigate if there is an exemption in terms of the Australian Tax Act.

Mr Smith’s total tax liability, in rands, will be R634,885, which is his South African tax liability of R2,565 and Australian tax liability of R632,320 (per tax computation 15: USD 63,232 * R10).

Tax computation summary

In this chapter, the practical application of the proposed repeal and enacted amendment to section 10(1)(*o*)(ii) and the alternative options available to prevent the double taxation of foreign remuneration from a South African tax resident earning foreign remuneration from Australia will be analysed.

The table below summarises the tax liability per options detailed above.

Tax computation	Rands	AUD	Total tax liability in Rands
Tax computation 8: Australian tax liability as a non-resident		71,685	716,850
Tax computation 9: no amendment to section 10(1)(*o*)(ii)	2,565	71,685	719,415
Tax computation 10: proposed repeal to section 10(1)(*o*)(ii)	785,490	71,685	1,502,340
Tax computation 11: amendment to section 10(1)(*o*)(ii)	351,890	71,685	1,068,740
Tax computation 12: proposed repeal to section 10(1)(*o*)(ii) considering the application of the DTA	68,640	71,685	785,490
Tax computation 13: proposed repeal to section 10(1)(*o*)(ii) considering the application of foreign tax credits (s 6*quat*)	20,777	71,685	737,627
Tax computation 14: proposed repeal to section 10(1)(*o*)(ii) considering the change of tax residency / tax computation 15: Australian tax liability as an Australian resident	2,565	63,232	634,885

Mr Smiths', as a South African tax resident, his foreign remuneration is subject to tax in Australia amounting to AUD 71,685 (R 716,850). Should section 10(1)(*o*)(ii) not be repealed or amended, Mr Smith's South African tax liability would be R2,565. This South African tax liability is a result of his South African rental income earned only. Mr Smith foreign remuneration would be exempt in terms of section 10(1)(*o*)(ii) for South African tax purposes. His total tax liability would be R719,415. As Mr Smith's foreign remuneration is only taxed in Australia and not in South Africa, the double non-taxation of income is not applicable. National Treasury's concern regarding the double non-taxation of income is omitted.

Should this section be repealed (assume that there is no DTA and section 6*quat* is not available) and Mr Smith does not apply a method to reduce his South African tax liability, Mr Smith's South African tax liability would be R785,490. In addition to his South African tax liability, Mr Smith's foreign remuneration would still be subject to tax in Australia as a non-resident taxpayer resulting in a total tax payable on his foreign remuneration of R1,502,340. As a result of this significant increase in South African tax liability, adverse consequences would result for Mr Smith as discussed in chapter 3. The repeal of this section results in the worst position for Mr Smith.

It should further be noted that this repeal results in the double taxation of foreign remuneration. This is an unintended consequence of National Treasury's decision to repeal section 10(1)(*o*)(ii), rather than to prevent the double non-taxation of foreign remuneration this decision to repeal resulted in the double taxation of foreign remuneration.

National Treasury is aware that the proposed repeal to section 10(1)(*o*)(ii) may result in adverse tax consequences for the expatriate such as the double taxation of foreign remuneration, and after taking into consideration public comment, decided to rather amend this section to include the one million rand exemption threshold than to repeal this section. Applying the amended section 10(1)(*o*)(ii), Mr Smith's South African tax liability would be R351,890. In addition to Mr Smith's South African tax liability, his foreign remuneration would be subject to tax in Australia as an Australian non-resident taxpayer as well. Mr Smith total tax liability would be R1,068,740 which puts Mr Smith's in a worse position if this section was not repealed but in a better position if this section was amended.

This amendment would achieve National Treasury's purpose to prevent the double non-taxation of income, but will still increase Mr Smith's South African tax liability significantly and result in the double taxation of foreign remuneration.

Should Mr Smith apply the foreign tax rebate (section 6*quat*), his South African tax liability would be R20,777. As Mr Smith's foreign remuneration was subject to tax in Australia, his foreign remuneration would be included in Mr Smith's South African taxable income and a foreign tax rebate would be available to reduce Mr Smith's South African tax liability. Mr Smith's foreign remuneration would be subject to tax in South Africa and in Australia resulting in the double taxation of foreign remuneration, however, the taxation on the foreign remuneration will be minimised by the section 6*quat* rebate. This puts Mr Smith in a better off position should section 10(1)(*o*)(ii) be repealed. His total tax liability would be R737,627 which includes Mr Smith's South African tax liability and his foreign remuneration would be subject to tax in Australia as an Australian non-resident taxpayer.

Should Mr Smith change his tax residency from South African to that of Australian, his South African tax liability would be R2,565 on his rental income received. The year after that Mr Smith chooses to change his tax residency, the foreign remuneration that he earns will not be subject to tax in South Africa. It should however be noted that as this foreign remuneration was not taxed in South Africa, this remuneration would still be taxed in Australia as an Australian tax resident, resulting in a total tax liability of R634,885. The option for Mr Smith to change his tax residency status from South African to Australian does not result in the double non-taxation or double taxation of this income.

Should Mr Smith rely on the DTA between South Africa and Australia his South African tax liability would be R68,640. The reliance on the DTA results in Mr Smith's foreign remuneration being taxed in South Africa and the net South African tax liability being reduced by the foreign tax paid in Australia as a non-resident taxpayer, reducing Mr Smith's tax liability. Mr Smith total tax liability would be R785,490.

From the above, it is evident that Mr Smith's tax liability is optimised if Mr Smith changes his tax residency from South African to Australian. This option minimises Mr Smith's tax liability and it prevents the double non-taxation or double taxation of foreign remuneration.

It should further be noted that National Treasury's purpose to repeal the section would not be necessary in this example as the current section 10(1)(*o*)(ii) (post amendment) does not result in the double non-taxation or double taxation of remuneration.

From the above practical examples, the best method for a South African tax resident who earns foreign remuneration from Australia would be to rely on the section 6*quat* rebate or to change their tax residency to reduce their South African tax liability should section (10)(1)(*o*)(ii) be repealed or amended.

CHAPTER 7: CONCLUSION

This report discussed how the proposed repeal of the foreign employment income exemption, section 10(1)(*o*)(ii) of the Act impacted South African expatriates and its impact on the South African economy.

Section 10(1)(*o*)(ii) was brought into the Act to prevent the double taxation of foreign remuneration when the South African tax system changed from a source-based system of taxation to a residency-based system of taxation, as the change in systems resulted in South African tax residents being taxed on their worldwide income instead of only their income from a South African source.

For foreign remuneration earned to be exempt from South African income tax in terms of section 10(1)(*o*)(ii) the remuneration would need to be earned for services rendered outside South Africa by an employee if the employee was outside South Africa for a period or periods exceeding 183 full days in aggregate during any 12 month period and for a continuous period exceeding 60 full days during that twelve-month period.

The original intention of National Treasury was met and foreign remuneration earned by South African expatriates was exempt in terms of section 10(1)(*o*)(ii), assuming the requirements of this section were met.

Of recent times, National Treasury was made aware that this section resulted in the double non-taxation of foreign remuneration and therefore proposed to repeal this section to prevent the double non-taxation of foreign remuneration. As discussed, the proposed repeal may result in adverse tax consequences for South African expatriates as well as adversely impacting the economy.

In chapter 5 and chapter 6 the tax consequences between South African expatriates earning foreign remuneration in the UAE and in Australia respectively, was analysed. The impact of the proposed repeal to section 10(1)(*o*)(ii) and the amended section was applied to scenarios and addressed. Lastly the options to prevent the double taxation of income was assessed.

In chapter 5 a conclusion was reached that the proposed repeal prevents the double non-taxation of foreign remuneration received by a South African expatriate residing in the UAE, resulting in this remuneration being taxed in South Africa. Should the South African expatriate residing in the UAE apply the DTA between South Africa and the UAE or change their tax residence from that of South African to the UAE, their tax position would be optimised and would result in the same tax position should section 10(1)(*o*)(ii) not be repealed or amended.

In comparison to the South African expatriate residing in Australia, the proposed repeal of section 10(1)(*o*)(ii) did not prevent the double non-taxation of foreign remuneration but rather resulted in the double taxation (as per the examples on the assumption that section 6*quat* and the DTA were not applicable) of foreign remuneration earned in Australia. Should the South African expatriate change their tax residence from that of South African to Australian, this taxpayer would be in their optimum tax position.

The biggest difference between a South African expatriate residing in the UAE and a South African expatriate residing in Australia is that no income tax is charged in the UAE opposed to Australia. Therefore, there was the probability that foreign remuneration earned from the UAE may be subject to the double non-taxation. In Australia, foreign remuneration earned by South African expatriates is subject to tax in Australia.

National Treasury's objective to prevent the double non-taxation of foreign remuneration earned by South African expatriates by repealing section 10(1)(*o*)(ii) may already seem unattainable due to different tax legislation in different countries. The different tax legislations in other countries imposes taxes on taxpayers, while some countries do not have income tax for taxpayers. Further the DTAs and South Africa and other countries are not consistent across all countries and therefore the prevention of double non-taxation of income may not be prevented as a result of repealing section 10(1)(*o*)(ii).

Should a South African expatriate residing in the UAE apply the DTA and the requirements of the DTA have been met resulting in their remuneration being taxable in the UAE, their tax position is the same should section 10(1)(*o*)(ii) be repealed or amended. Therefore, the proposed repeal and enacted amendment will not prevent the double non-taxation of foreign remuneration of South African tax residents due to the alternative options available.

In comparison to the South African expatriates residing in Australia, the proposed repeal would result in the double taxation of foreign remuneration which was not the intended intention of National Treasury. In the absence of the section 6*quat* rebate, the DTA or the option to changing their tax residency status, the expatriate's foreign remuneration earned in Australia would be taxed both in Australia and South Africa.

The proposed repeal and the enacted amendment, in certain situations, does not meet the objective of National Treasury to prevent the double non-taxation of foreign remuneration earned by South African expatriates due to the alternative options available to South African taxpayers to reduce their South African tax liability.

TABLES

South African tax tables

Rates of Tax for Individuals

Table 1: 2018 tax year

Taxable income (R)	Rates of tax (R)
0 – 189,880	18% of taxable income
189,881 – 296,540	34,178 + 26% of taxable income above 189,880
296,541 – 410,460	61,910 + 31% of taxable income above 296,540
410,461 – 555,600	97,225 + 36% of taxable income above 410,460
555,601 – 708,310	149,475 + 39% of taxable income above 555,600
708,311 – 1,500,000	209,032 + 41% of taxable income above 708,310
1,500,001 and above	533,625 + 45% of taxable income above 1,500,000

Source: https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Rates%20of%20Tax%20for%20Individuals.aspx

Australian Tax Tables

Rates for Non-Resident Individual Income Tax

Table 2: 2018 tax year

Taxable income	Tax on this income
$0 – $87,000	32.5c for each $1
$87,001 - $180,000	$28,275 plus 37c for each $1 over $87,000
$180,001 and over	$62,685 plus 45c for every $1 over $180,000

Source: https://www.exfin.com/australian-tax-rates

Rates for Resident Individual Income Tax

Table 3: 2018 tax year

Taxable income	Tax on this income
$0 – $18,200	Nil
$18,201– $37,000	19c for each $1 over $18,200
$37,001 - $87,000	$3,572 plus 32.5c for each $1 over $37,000
$87,001 - $180,000	$19,822 plus 37c for each $1 over $87,000
$180,001 and over	$54,232 plus 45c for every $1 over $180,000

Source: https://www.exfin.com/australian-tax-rates

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