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Sir

DRAFT INTERPRETATION NOTE: EXEMPTION FROM INCOME TAX: REMUNERATION DERIVED BY A PERSON AS AN OFFICER OR CREW MEMBER OF A SHIP

We refer to the request to comment on the draft interpretation note (issue 2) dealing with exemption from income tax: remuneration derived by a person as an officer or crew member of a ship. In our comments below, when we refer to this draft note, we will use the abbreviation “Draft Note”.

The comments are presented in the order of the relevant paragraphs as they are found in the Draft Note, but we start with a general comment first.

General comment

It is not clear why the interpretation note doesn't also deal with an officer or crew member of a South African ship (as envisaged in section 12Q).

Section 10(1)(o)(iA) also exempts remuneration of an officer or crew member of a ship of a South African ship. It also refers to ‘international shipping’ and fishing.

We suggest that it would be useful to also include the exemption provided for in section 10(1)(o)(iA) in the same Interpretation note.

Comments on paragraph 4.1 - Remuneration

The discussion of the term “derived by”

Section 10(1)(o)(i) uses the phrase “remuneration derived by” in the context of a person as an officer or crew member and then “remuneration received by or accrued to” when it relates to employees. We accept that there is a reason why the legislator didn’t use the words “received by or accrued to” in section 10(1)(o)(i) and (iA). The words “received by or accrued to” is not relevant here as the definition of ‘remuneration’ in paragraph 1 of the Fourth Schedule uses the words ‘paid or payable’.

The English precedent quoted in the Draft Note relates to the meaning of the phrase ‘from which revenue is derived’ and then accepts that the word “derived” is treated “as synonymous with arising or accruing” when used in ‘derived from’. It concludes by saying “to fall within the language of the proviso the revenue must flow or accrue directly from ...”

The Oxford Dictionary (at <http://www.oxforddictionaries.com/definition/english/derive>) gives the meaning of the word derive (in English to “obtain something from (a specified source)”.

The word ‘derive’ is a word most commonly found in a double taxation agreement. See for instance the most recently in force agreement between the government of the Republic of South Africa and the government of the state of Qatar. In Article 14(3) it refers to “remuneration derived in respect of an employment exercised aboard a ship”.

The OCED commentary, admittedly when it deals income which has “flowed through” a transparent partnership to the partners who are liable to tax on that income in the State of their residence, explains that “it is to them (the partners) and not to the partnership that the income is allocated for purposes of determining their tax liability”. It then continues to say that “the partners ... satisfy the condition, ... imposed by some other Articles, that income or gains are “derived by a resident of the other Contracting State” is met ...”

The purpose of the word ‘derived’, when used in section 10(1)(o)(i) and (iA), is to link the remuneration to the officer or crew member. We therefore agree with interpretation “that there must be a causal connection between the remuneration received, and the person’s role as an officer or crew member on the ship, in order for the exemption to apply. Any remuneration derived outside the Republic other than as an officer or crew member of a ship, does not qualify for exemption under this provision.”

The suggestion is that the part “In Port Elizabeth Municipality...” to “(Emphasis added.)” can be removed from the draft note.

The comments relating to ‘the year of assessment’

The relevant part in the legislation reads as follows:

“... if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment ...”

The Draft Note states that the “remuneration that is covered by the exemption relates only to remuneration derived by a person during a year of assessment”.

The point, as comes through in the example, is that remuneration will only be exempt under section 10(1)(o)(i), if the individual concerned meets the more than 183 full days’ requirement in the relevant year of assessment.

The wording, quoted above, can be misunderstood because it doesn’t mention the 183 days’ requirement.

We don’t believe that the words “... if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment ...” requires interpretation. It is

however important in the context of the interpretation of the sub-section as a whole and should be dealt with in the interpretation note – in other words not only in the example.

The principle then is that when the remuneration relates to a period that spans more than one year of assessment, the remuneration so derived in respect of a year of assessment where the individual didn't meet the 183 full days' requirement will not be exempt.

The statement that the person in the example "does not qualify for exemption as it was not derived during the same year of assessment" should also be reworded accordingly. In other words, it is not because the days in the next year cannot be counted for the test in the previous year. It is because the individual doesn't meet the more than 183 full days' requirement in that year (the second one).

Comments on paragraph 4.2 - Any person as an officer or crew member

The Draft Note states the following:

"The person must be an employee in order to qualify for the exemption. A person cannot be an officer or crew member aboard a ship without also being an employee."

It then, in the footnote explains that "this is the case is clear from the provisions of the Merchant Shipping Act ..."

The definition of employee in Merchant Shipping Act (No. 57 of 1951) reads as follows:

"employee" means any person on board a vessel, including a member of the crew, who is employed by or working for an employer and receives or is entitled to receive any remuneration, or who works under the direction or supervision of an employer, or any other person who on board a vessel in any manner assists in the carrying on or the conducting of the business of an employer, except as provided otherwise by regulation;

Neither section 10(1)(o)(i) or (iA) uses the word employee. It also doesn't link it to the definition of employee in paragraph 1 of the Fourth Schedule. We agree that a treaty may have an employment link – see again the Qatar treaty that refers to “in respect of an employment exercised aboard a ship”.

The point then is that a person “who works under the direction or supervision of an employer” (as envisaged in the definition above), may well do so in the capacity of an independent (and not employee). In such an instance the person will not “be an employee” at common law. The person will be an employee in terms of the Merchant Shipping Act.

The interpretation in the Draft Note is that “in order to qualify for the exemption” the person “must be an employee” is not correct. The exemption applies if the person is “an officer or crew member” and not if the individual is an employee as defined in the Merchant Shipping Act.

We suggest that the part “The person must be an employee in order to qualify for the exemption” and the part “a person cannot be an officer or crew member aboard a ship without also being an employee” be removed from the Draft Note.

Comments on paragraph 4.3.1 - Ships engaged in international transportation

Fishing

An example, the transport of fish, is used in this paragraph. Section 10(1)(iA)(bb) refers to ‘fishing’, and as suggested earlier in this document, we believe it should be dealt with in the Interpretation note as well.

Passage

The paragraph, in footnote 9, refers to a definition in section 1 of the Marine Traffic Act No. 2 of 1981. The definition, which has been amended in 1997, reads as follows:

“passage means navigation through the territorial waters in a continuous and expeditious manner for the purpose of—

(a) traversing those waters without entering internal waters or calling at a roadstead or offshore installation outside internal waters; or

(b) proceeding to or from internal waters or a call at any such roadstead or offshore installation,

and includes stopping and anchoring, in so far as such stopping or such anchoring is incidental to ordinary navigation or is rendered necessary by vis major or distress or is for the purpose of rendering assistance to persons, ships or aircraft in danger or distress”.

As this is important to the interpretation of section 10(1)(i)(bb) we suggest that the definition be included in the Draft Note. It is important enough to not only deal with it a footnote.

Comments on paragraph 4.5 - Days test

Secondment

In terms of the Draft Note the documentation to substantiate their absence from South Africa include “... letters of secondment ...” We accept that SARS may request these, but query the reason therefore. A letter of secondment will not in all instances be necessary or available. We also fail to see how it can be relevant to prove days of absence.

Surely the employment contract and the passport would be the only documentation required to prove this.

Comments on paragraph 5 - General provisions

In the fourth paragraph under this heading it is stated that:

“Remuneration that is exempt under section 10(1)(o)(i) is not “remuneration” as defined in paragraph 1 of the Fourth Schedule.”

This may be a bit confusing to an ordinary reader of the Draft Note as section 10(1)(i) refers to “any form of remuneration as defined in paragraph 1 of the Fourth Schedule”. We agree with the point that it will not be ‘income’ when the exemption applies.

The point is that it must in the first instance be remuneration (as defined) before the exemption can apply. The consequence of that is that once the exemption applies it would then convert the remuneration into something that is not income and consequently not remuneration as required by the other two Acts referred to. This is not only relevant for the other two Acts, but also for employees’ tax purposes.

It is suggested that the ambiguity be removed it can be done by changing the following:

“Remuneration that is exempt under section 10(1)(o)(i) is not “remuneration” as defined in paragraph 1 of the Fourth Schedule. As such amounts are not “remuneration”, they ...”

to

To the extent that the amounts are exempt under section 10(1)(i) they are not subject to unemployment insurance fund contributions under the Unemployment Insurance Contributions Act No. 4 of 2002 or the skills development levy under the Skills Development Levies Act No. 9 of 1999.

Comments on paragraph 6 – Conclusion

We agree that it “may ... be possible that the remuneration of these officers or crew members qualify for the exemption under section 10(1)(o)(ii) as is stated.

As there is an Interpretation Note that deals with it, we suggest that reference to it is made. It can be in a footnote.

Please feel free to contact us if any clarification is needed with regard to our comments.

Yours sincerely,

Piet Nel

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