SUBMISSION TO NATIONAL TREASURY

FOREIGN REMUNERATION EXEMPTION

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1. INTRODUCTION

The industry has prepared this submission in response to the following proposal, contained in Annexure C to the 2017 National Budget:

> *"**Amending foreign employment income-tax exemption in respect of South African residents***
> *Currently, if a South African resident works in a foreign country for more than 183 days a year, foreign employment income earned is exempt from tax, subject to certain conditions. This exemption is for employees of private-sector companies. In terms of the residence-based system of taxation, South African residents are taxed on their worldwide income. However, this exemption on foreign employment income appears excessively generous. If a resident works in a foreign country for more than 183 days with no tax payable in the foreign country, that foreign employment income will benefit from double non-taxation. It is proposed that this exemption be adjusted so that foreign employment income will only be exempt from tax if it is subject to tax in the foreign country."*

The following parties have participated in the drafting of the submission: Deloitte; EY; KPMG; PWC; SAICA and SAIT. The purpose of the submission is to share information that is available to these firms and institutes with National Treasury (NT); and to make **recommendations** based on our and **analysis** and **conclusions** on the anticipated effect in the event of the deletion of section 10(1)(o)(ii).

We appreciate the ongoing opportunity to participate in constructive engagement and consultation as part of the tax legislative process. We look forward to our future engagement.

2. EXECUTIVE SUMMARY

2.1 Introduction

The submission consists in the main of an analysis of the legislative framework within which section 10(1)(o)(ii) operates as well as the practical application of the exemption. We investigate the anticipated results should the exemption be deleted and make specific recommendations. Refer to paragraph 2.2 hereunder.

We are aware that the world of global mobility tax is highly specialised and that information on this discipline is not always readily available. In an effort to provide some background information, and to create a clearer picture of the world we operate in, the participants each addressed specific area/s of relevance. These research pieces are contained in the Annexures to the document. Whilst the content of the Annexures reflects the approach/experience of the particular participants who compiled the pieces, the discussion (**paragraph 3. Analysis of the potential impact of section 10(1)(o)(ii) proposal**) is representative of the views of the entities as a collective.

2.2 Summary of analysis, conclusion and recommendations

In our **analysis** we address the following matters:

- The importance of protecting the individual taxpayer base in South Africa (SA);
- The introduction of section 10(1)(o)(ii) as a relief measure for double taxation at the time of the introduction of the world-wide basis of taxation in SA.;
- The design of section 10(1)(o)(ii) in relation to a similar measure in Double Taxation Treaties (DTT);

- The legislation around SA tax residents, breaking tax residence, the effect of the exit charge and the interrelationship with section 10(1)(o)(ii), including references to other tax jurisdictions;
- The application of the exemption in the case of SA tax residents that directly take job opportunities abroad (Group A);
- The application of the exemption on international and SA employers and their employees (Group B), with specific reference to the Head Quarter Company (HQC) regime, foreign inward investment, and tax as a factor in competitive labour cost.

In our **conclusion** on the anticipated effect in the event of the deletion of section 10(1)(o)(ii), we list:

- The increased cost of employment for SA and international employers with SA tax resident employees operating in foreign tax jurisdictions (due to the tax equalisation or tax protection offered by the employer, including the resultant gross-up), with reference to the application of any DTT and the tax credit;
- The increased administrative burden (and resultant cost) for employers
- The effect of the deletion of section 10(1)(o)(ii);
- The effect on existing projects, foreign inward investment, the HQC regime, and the individual income tax base.

Based on the analysis provided, we **recommend** that prior to amending or deleting section 10(1)(o)(ii), an investigation be conducted in respect of:

- The interplay between individual tax residency, the exit charge, and section 10(1)(o)(ii);
- The resultant economic effect on existing business, and the possible fallout;
- Anticipated future foreign investment, and the status of SA as the platform of choice;
- The cost to, and ability of, SARS and taxpayers (employers and individuals) to meet and address the administrative and compliance burdens;
- The competitiveness of SA labour against competing countries; and
- The effect on the individual and corporate tax base in the long term.

2.3 List of Annexures

Annexure A – Contains comparable information of the tax treatment of seven of SA's main global trading partners and competitors.

Annexure B – Contains a schedule of countries with no or low income tax. This information provides context of which countries are no/low tax jurisdictions and with which of these countries SA has a DTT.

Annexure C – Contains a discussion regarding the breaking of tax residency

Annexure D - Contains a description of how expatriate tax policies with tax equalisation or tax protection by the employer would typically work

Annexure E – Contains a discussion of the practical implications of the administration of Foreign tax credits (FTC's)

3. DISCUSSION - ANALYSIS OF THE POTENTIAL IMPACT OF SECTION10(1)(O)(II) PROPOSAL

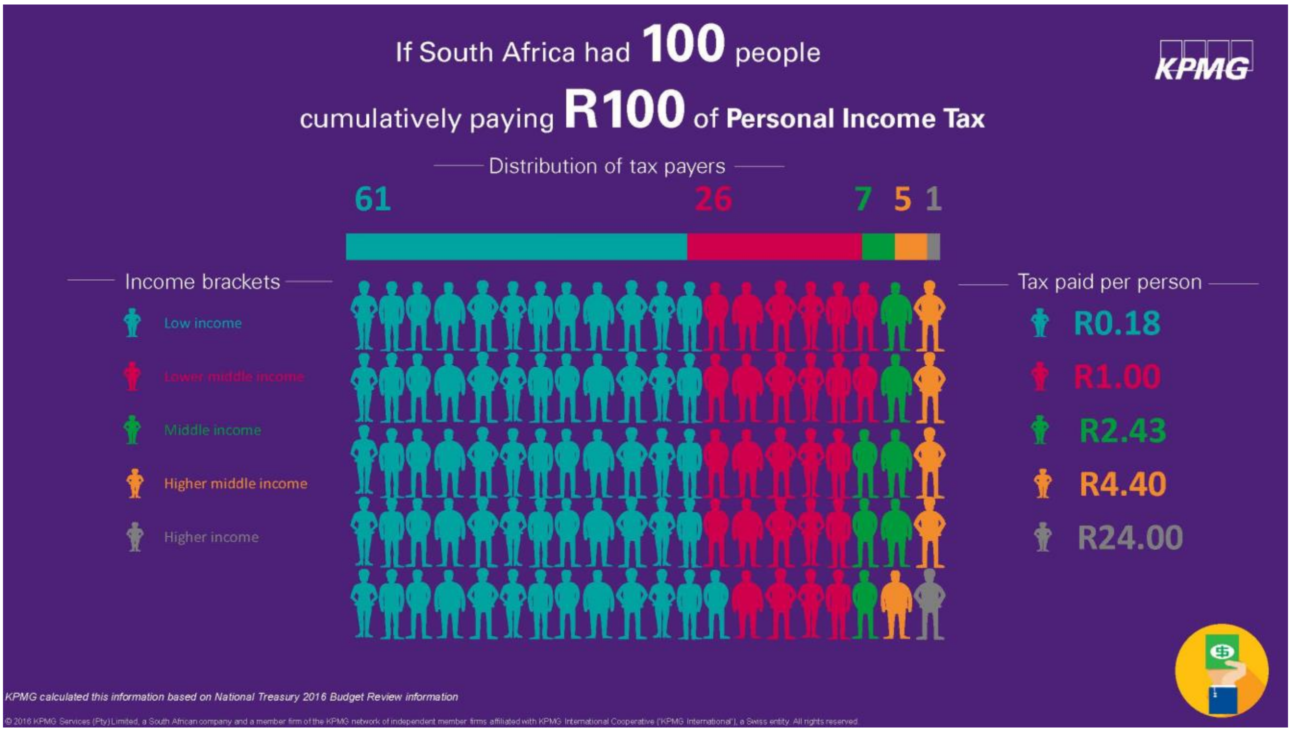
3.1 The individual taxpayer in South Africa's tax regime

According to the Tax Statistics for 2015/2016[1], jointly released by the National Treasury (NT) and the South African Revenue Service (SARS) on 29 November 2016 total tax revenues collected consisted of:

— Personal Income Tax (PIT) – 36.4%
— Value-Added Tax (VAT) – 26.3%
— Corporate Tax (CT) – 18.1%
— Import VAT and Customs Duties – 18.4%
— Other - 0.8%

The cost of revenue collection ratio for 2015/2016 was 0.96% (the international benchmark of 1%).

South Africa has a progressive income tax system, with the marginal tax rates ranging from 18% to 45%. However, South Africa's highest marginal tax rate of 45% for individuals earning above R1 500 000 per annum is high in comparison to other countries[2]. Whilst there are other countries with high individual tax rates, South Africa (SA) can be distinguished in that, due largely to the inequality created by apartheid, the SA fiscus is reliant on a very small base of individual taxpayers from which to collect the required PIT - refer to the graph hereunder for 2015/2016.



[1] Unfortunately the Tax Statistics for 2016/2017 were not released at the time of writing.
[2] Refer to KPMG's individual income tax rates table provides a view of individual income tax rates around the world (https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/individual-income-tax-rates-table.html)

If one then also considers the fact that PIT represents 36.4% of SA's fiscal income, it becomes apparent why protecting the individual tax base is of critical importance, and why NT would seek to craft policies and legislation that will protect this tax base.

3.2 Section 10(1)(o)(ii)

3.2.1 Description of the section

South African residents are generally taxable on their worldwide income, including remuneration for employment undertaken outside SA.

In terms of section 10(1)(o)(ii), any form of remuneration received by or accrued to an employee during any year of assessment in respect of services rendered outside the SA by them for or on behalf of any employer, is exempt from tax if the employee concerned was outside SA:

- for a period or periods exceeding 183 full days in aggregate during any twelve-month period;
- for a continuous period exceeding 60 full days during that twelve-month period, and
- the services were rendered during the period or periods of absence from SA.

Section 10(1)(o)(ii) was inserted at the time when the residence basis of taxation was introduced in SA. The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2000 (EM-2000) states the following:

> *"Bearing in mind that all other residents will now be taxed on their worldwide income regardless of whether they were physically present in the Republic or not, the provisions of section 10(1)(o) need to be revised. Internationally it is accepted practice to exempt foreign employment income of a resident if the resident was outside his or her country of residence for a period exceeding 183 days (in some countries even as little as 91 days if the income was taxed elsewhere).*
> *It is, therefore, proposed that the principle contained in section 10(1)(o) should be retained. It is also proposed that the principle should be extended to include residents who are outside the Republic, for purposes of rendering services outside the Republic for or on behalf of their employer, for a period which in aggregate exceeds 183 full days in a 12-month period commencing or ending during a year of assessment and for a continuous period exceeding 60 full days during such 183 day period.*
> *The effect of this relief measure will be monitored to determine whether certain categories of employees abuse it to earn foreign employment income without foreign taxation".*

As was acknowledged in EM-2000, section 10(1)(o)(ii) was inserted primarily to avoid double taxation in line with internationally accepted practice around the allocation of taxing rights in respect of employment income to the country of residence versus the country of source. Furthermore, it was clear that even though section 10(1)(o)(ii) would operate outside the DTT network, the intention was that the provisions would mirror the 183-day test found in most tax treaties.

However, it was indicated that the effect of the relief measure would be monitored to determine whether certain categories of employees abuse it to earn foreign employment income without foreign taxation.

3.2.2 South African tax residents

The concept of 'resident' is fundamental to the residence-based system of taxation.

A person who qualifies as a "resident" as defined in section 1(1) is subject to tax in SA on receipts and accruals from all sources subject to certain exceptions and subject also to the possible application of any applicable double tax agreement, which may have the result of exempting the gain from tax in SA. A non-resident, that is, a person who does not qualify as a 'SA tax resident', is subject to tax in SA only on receipts and accruals from a source within SA, again subject to certain exceptions.

The following persons are defined as being SA tax resident:

— A natural person who is ordinarily resident in the Republic.
— A natural person who is not at any time during the year of assessment ordinarily resident in SA, if such person is physically present in SA for certain periods (the physical presence test).

However, an individual is excluded from being tax resident in SA in respect of certain receipts or accruals, to the extent that the individual is, due to the application of a DTT between SA and another country (the so-called tie-breaker clause), exclusively tax resident of that other country.

Individuals, far more than corporations, can relocate and generally change tax residency, in line with their employment and living arrangements. However, not only is it relatively difficult to break individual tax residency in SA (unless one specifically sets out to do so) due to the dual tests, but the exit charge in section 9H could also make it prohibitively expensive depending on the individual's circumstances. In short, it is easy to become a SA tax resident through intention or physical presence, but relatively hard (and often expensive) to lose SA tax residency.

From the point of view of the fiscus, this position is satisfactory because the individual tax base is being protected in that individuals with SA tax residency are incentivised not to break tax residency, lest they suffer the exit charge.

Section 10(1)(o)(ii) provides relief not only in respect of double tax but also in allowing an individual to remain a SA tax resident even when they work extensively abroad. By comparison, the United Kingdom (UK), does not have a foreign employment exemption for residents. However, there is no real need for such an exemption because UK residents will generally break UK tax residence if they leave the UK to work abroad for a complete UK tax year. Once the individuals are non-resident, they do not pay tax on foreign income in any case. The UK does not have an 'exit tax' as South Africa does, so there is no downside to breaking residence.

An 'ordinarily resident' South African will usually remain a tax resident of South Africa (and taxable on worldwide earnings), unless they emigrate permanently abroad or a tax treaty deems them to have broken residency.[3] When the individual breaks their tax residency, they will pay the 'exit tax', which is capital gains tax (CGT) on the deemed disposal of their worldwide assets, excluding South African real estate. The UK and South African systems cannot be compared once these factors are considered.

[3] 'SARS takes aim at tax exemption for foreign employment', by Dan Foster, then Associate Director at KPMG Tax, published in Moneyweb on 15 May 2013.

"*Taking another example, Australia abolished its foreign employment exemption several years ago (contained in the former section 23AG of their tax code). This would seem a better example for SARS, since Australia also has an exit tax. However, closer examination reveals that it is, again, much easier to break Australian tax residency when going on, say, a three-year foreign assignment, than it is for a South African working abroad. In addition, the Australian exit tax is subject to an election whereby an emigrant can opt-in to the exit tax on non-Australian assets upon departure, or remain subject to full CGT post-departure. No such election exists for South Africans breaking residency. Again, once the full picture is revealed, the two tax systems cannot be compared.*"[4]

3.2.3 Budget proposal

According to the Budget proposal, NT proposes to amend the foreign employment income tax exemption in respect of South African residents, mostly to prevent tax leakage through SA tax resident individuals working in tax jurisdictions where they pay a lower income tax rate than in South Africa.

It is stated in Annexure C to the Budget Review, that the "*exemption on foreign employment income appears excessively generous*". From the proposal, we understand that it is NT's view that the negative consequences (e.g. double taxation) will be dealt with through existing mechanisms such as the SA (DTT) network, and the tax credit system.

We review hereunder the application of section 10(1)(o)(ii).

3.2.4 Application of section 10(1)(o)(ii)

Section 10(1)(o)(ii) is being used by two distinct groups:

- Group A: SA tax residents that directly take job opportunities abroad.
- Group B: SA tax residents that comprise of original SA tax residents, or international assignees that have become SA tax residents due to physical presence or due to becoming ordinarily resident. Group B is formally employed by a South African or international employer, and are sent outside SA on assignment in countries where their employer's group operates.

Group A

Group A are often employed by international employers who do not have a SA presence and we do not have any specific details available on their circumstances. Anecdotally, these individuals take jobs abroad for international experience, in order to support their families, and/or due to lack of opportunity in SA. Typically, these individuals do not break tax residence because they plan on returning to SA once their term contract is complete. The individual's family either relocates temporarily with them, or their family remains in SA.

Typically, Group A individuals would continue to be tax resident in SA. The individuals are often responsible for their own taxes and compliance. If and when they hand in SA tax returns they would claim section 10(1)(o)(ii) in respect of any foreign-earned income.

Group A is not affiliated to any specific business and the effect of removal of section 10(1)(o)(ii) would impact the individuals themselves.

[4] Moneyweb article.

E.g. Maria (44, a divorced mother of 24 year old twin boys), had a lecturing position in Johannesburg but her 3 year term contract came to an end in December 2016. Maria could not find similar employment and was concerned that she would be unable to provide the tuition fees for her sons to go to university and make payments on her bond (her primary residence is her only asset). Maria decided to investigate opportunities abroad. Maria was successful and is going to Dubai in August 2017 to teach.

Analysis

Under the current dispensation, Maria can remain a SA tax resident and continue to file tax returns until her (probable) return in 3 years' time. However, in light of the possibility of section 10(1)(o)(ii) being deleted, she will ensure that she breaks her SA tax residency. She would have preferred to return to SA but she will wait to see whether her sons will relocate abroad before making a final decision.

In Maria's case the exit charge will have no effect and she will gladly exit the SA tax net in order to save between 30% - 45% in tax. However, due to the high cost of living in Dubai (in part due to the high customs and excise charges), Maria is aware that whilst she will be able to send money home to SA, she will not in fact be able to save significantly more than she would have in SA.

From the SA fiscus' point of view, Maria is an individual taxpayer that ceased tax residency in August 2017. There is no incentive for Maria to remain a SA tax resident (or even to return to SA). To be clear, Maria is not specifically looking to benefit from a tax-free jurisdiction inasmuch as she is looking for a job opportunity to make ends meet. Dubai will not change its tax regime, irrespective whether section 10(1)(o)(ii) remains unchanged or is deleted. Maria (and many other South Africans) cannot afford to let the opportunity go, if they do, they will just be replaced with other skilled resources from another jurisdiction.

We shall not deal in detail with Group A on the basis that we do not have extensive experience with these individual taxpayers.

Group B

South Africa has long been positioned as the 'gateway to Africa', being an appropriate base of operations from which a connection can be established between the regional level and the global level of the world economy, creating a flow of wealth, ideas, and people. From a tax side, the Katz Commission recommendations saw the formation of headquarter companies (HQC) located in SA.

The aim was to grow the SA economy through encouraging local investors to expand outside its borders and by encouraging foreign investors to expand into the rest of Africa via SA.

Many of the companies employing the individuals in Group B, have established their base of operations in SA, either as a HQC or as a subsidiary of an international group with the task of expanding into the rest of Africa. By setting up a base of operations in SA, these companies provide opportunities for SA tax residents to go on assignments into the rest of Africa.

In our experience, the projects specific to the Africa region generally vary in length depending on the investment being made by the entities involved (periods from 10 years to on-going projects are commonplace). The periods for which SA companies assign their employees to these countries depend on the circumstances and differ from company to company. For example, some employees are sent as Long-Term assignees for 5 - 6 years, other employees qualify as Short-Term assignees for 2-3 years and others as Short-Term business travellers (who do not qualify for the exemption) for up to 6 months.

The number of assignees will also depend on the skills required. Projects which require specialised skills (i.e. energy, oil and gas, construction companies) typically draw more assignees. Other notable industries that send employees on assignment include the pharmaceutical and telecommunications industries.

SA employers send employees on assignment to most other African countries including Mozambique, Ghana, Nigeria, Kenia and Zambia. SA employers also send assignees to European countries such as the UK and Germany as well as to the USA, amongst others.

Operating in a global environment, the cost of SA labour is viewed as expensive and we find that countries like the Philippines and India are able to compete with local South Africans at a much more efficient cost.

In our experience, the level of skill and the corresponding salaries vary from project to project. Ultimately the aim of the business is to source the best skills at a reasonable cost. Tax as part of labour cost (refer to the discussion on tax equalisation in Annexure D) plays a major role and multinationals include tax cost as a determining factor in their search for alternative labour resources across the globe.

Alternative methods of employing these resources is also considered, and localising the assignee in the country of assignment is clearly the most popular trend. In the case of localising an assignee, the assignee will most likely will be regarded as resident in that country, and assignees may have no choice but to consider the option of breaking tax residency in SA.

Individuals who benefit from the exemption range from low income earners (e.g. in mining and construction which employs large numbers) to top management who are high income earners.

The trend is that employers are cutting back on allowances and benefits for assignees. Low-income earners often live in very basic employer-provided accommodation and even shared accommodation. Although so-called cost of living or hardship allowances are provided on occasion, these often act as compensation for individuals to accept difficult living conditions and the hardship of separation from their families.

3.2.5 Effect of deletion of section 10(1)(o)(ii) – Group B

General

If section 10(1)(o)(ii) is deleted, the cost-of-employment in the hands of South African employers who assign employees to foreign jurisdictions may be significantly increased to the extent of the additional tax burden borne by the employer (due to the tax equalisation or tax protection offered by the employer, including the resultant gross-up).

Whereas one would ordinarily refer to the general tax rates applicable in a country, on occasion, companies establishing a project in certain African countries, may negotiate a lower tax rate for period on employment, corporate taxes, etc. In these instances, the project cost would be based on a low to no individual tax rate for employees on the project.

We discuss hereunder our analysis of the probable effect should section 10(1)(o)(ii) be deleted.

DTT

In the case of no/low tax jurisdictions (whether due to special dispensation or as a result of general tax policy), the major relief available to an individual SA tax resident taxpayer (and the affiliated employer) working abroad would be if there is a DTT between SA and the country of source that gives the country of source taxing rights in respect of the income earned by the individual whilst on assignment in that country.

However, the application of a DTT is fairly complex and often requires an individual to seek tax advice. It is fair to say that the application of various DTT (and the resultant interpretational issues), rather than the exemption will increase the current administration required by the exemption (for SARS and the taxpayer).

Tax credit

Unfortunately, there is little relief available in the absence of a DTT between SA and a particular foreign country or where the DTT does not provide exclusive taxing rights. To the extent that individual income tax has been paid in the country where the services have been rendered, a tax credit in terms of section 6*quat* may be available in SA. The section 6*quat* rebate will be limited to the amount of tax the individual would have paid had the income been earned in SA.

As has been stated previously, SA has a particular split in revenue collection with a 45% marginal income tax rate. Other countries have taxes that, although born by employed individuals, do not qualify as income taxes (e.g. social security, etc.). No tax credit will be available in respect of taxes, although paid, that do not qualify as income tax.

Furthermore, an individual claiming relief through the use of foreign tax credits can only do so when they submit their own tax return. Up until that point, the individual must still make payment of all taxes due in both affected countries. It is evident that a cash flow problem will occur where tax is due and payable on a monthly basis in the foreign country as well as to SARS. A further complication is that providing sufficient proof of foreign taxes paid is often quite difficult. Certain self-assessment taxes do not require assessment from the revenue authorities and the only proof that the individual would have of taxes paid would be their foreign tax return. In addition, differing tax years cause complexity in calculating the credits available.

Whilst it is foreseeable that a mechanism may be found to mitigate the cashflow problem (e.g. allowing employers to apply the expected tax credit in advance on the payroll), the additional administration and compliance requirements (on the side of SARS and the taxpayer) will be substantial. Other than the low rate of recovery through the rebate (in the case of no/low tax jurisdictions), the administrative constraints will also play a role in adding additional cost to the project.

By merely providing a tax credit under these circumstances, affected SA tax residents would be forced to break tax residency. Alternatively, affected employers will have to absorb the additional cost and administration and consider employing non-SA tax residents or relocating. In our view, the knock-on effect on current projects and future inward foreign investment would be significant and would run contrary to all of NT's other tax and exchange control initiatives to encourage foreign investment, particularly into Africa.

3.2.6 Summary

In summary, without the exemption, the tax liabilities of outbound expatriates will be higher (since South Africa has a higher rate of tax than most African countries, so the final tax paid would be higher than the foreign tax, even after applying foreign tax credits). Employers will be forced to reimburse the individuals for this additional cost (e.g. tax equalisation), which in turn needs to be grossed-up. Ultimately, it will be South African companies investing abroad that will suffer from this change. In addition, the individuals' tax returns will become far more complex and costly to prepare, with amended returns for credit claims being required once foreign tax is paid in the host country. The refunds from these claims can take years to be paid, as SARS often insists on auditing refunds and verifying bank details in person, leaving the taxpayer (and ultimately the employer) out of pocket in the interim.[5]

The incentive for SA tax residents to remain within the SA tax net will be counteracted by the high cost for the individual and the affiliated employer. We anticipate that there will be a dent in the individual tax base, with a temporary exit charge being offset by the loss of sustained income tax over the longer term, and a sustained loss of skilled individuals who have been forced to cut their ties with SA.

Lastly, based on our analysis, there will be a substantial increase in the cost of doing business for employers sending SA tax residents abroad. We are in particular concerned about the likely effect on the status of SA versus other counties (e.g. Mauritius) as the preferred platform for regional expansion, and the direction that foreign investment would take in future.

[5] Paraphrased from Moneyweb article.

ANNEXURE A

Comparable information of tax treatment of outbound assignees by other jurisdictions

Tax relief for outbound individuals can take many forms. These include exemptions, credits and other types of domestic relief. The intention of this section is to provide some broad comparatives based on some of South Africa's main global trading partners and competitors. It should be noted that due to differing tax residence determinations, tax rates and treaty networks it is hard to provide exact comparatives to South Africa. As such these should be viewed as providing a broad overview of what is followed in other states in their treatment of outbound assignees. Of particular importance in viewing this information is the relative ease with which outbound assignees (with the exception of the US) can break tax residence. Therefore, the need for other jurisdictions to have an equivalent of South Africa's S10(1)(o)(ii) exemption is often not critical given that outbound assignees would often cease domestic tax residence for assignments of 1 or 2 years abroad. Due to the SA ordinarily resident test there would not be the same levels of cessation of residence of outbound assignees (unless under DTA tie-breaker provisions).

Many of the countries also have advanced self-assessment systems and efficient mechanisms for the delivery of exemptions and reliefs. In the event of an amendment to S10(1)(o)(ii) there would need to be considerable attention focussed on how administration of tax reliefs can be provided in SA. This is required as the existence of S10(1)(o)(ii) has assisted up to now in a reduced level of SARS administration in granting of tax relief to outbounds.

We have set out in this section some broad information on outbound expatriates from the following countries:

South Africa	Annexure A-1
Australia	Annexure A-2
Germany	Annexure A-3
China	Annexure A-4
Hong Kong	Annexure A-5
India	Annexure A-6
UK	Annexure A-7
US	Annexure A-8

We would be happy to provide additional information either in regard to these specific countries or other countries should this be of benefit.

Please click on the links below for additional documentation from Revenue authorities:

United Kingdom
United States
Australia
India

ANNEXURE A-1

Country: South Africa

How is tax residence determined?

Tax Resident where the individual meets the requirements of either the Physical Presence Test or Ordinarily Resident Test.

How is tax residence ceased?

Where the individual is no longer resident under the SA domestic residence tests or is viewed as exclusively treaty resident of a country with which South Africa has a Double Taxation Agreement.

Taxation basis for Residents

Residents are taxed on worldwide income and worldwide capital gains.

Taxation basis for non-Residents

Non-resident individuals are taxed on South African sourced income only. Capital gains typically on SA immovable property only.

ER Withholding obligation on Outbound Expatriates

Non-resident – No employer withholding obligation where duties rendered outside of South Africa.
Resident **–** ongoing PAYE requirement unless the conditions of S10(1)(o)(ii) exemption is met in which case employer can choose to cease withholding.

Reliefs applicable for Outbound Expats

Resident - S10(1)(o)(ii) exemption applicable to individuals who work outside of SA for in excess of 183 days and in excess of 60 consecutive days in a 12-month period. Foreign tax credit available under domestic legislation and treaty provisions in the event of double taxation.
Non-resident – remains taxable on remuneration related to SA rendered services. Not taxed on remuneration related to non-SA rendered services.

Methods of Claiming

Cessation of payroll withholding is allowed where the conditions of S10(1)(o)(ii) exemption is met or where remuneration is being paid to a non-resident for non-SA rendered services.
Final tax credits and exemptions determined and claimed at year end in the tax return

Administrative Processes

SA tax authorities will typically seek proof of S10(1)(o)(ii) exemption being met (e.g. stamped pages of passport, assignment contract, employer confirmation). For FTC claims will look for proof of foreign taxes paid.

Other Comments

Significant administrative difficulties presently in SARS correctly assessing exemption/credits. Significant delays in refunds.

ANNEXURE A-2

Country: **Australia**

How is tax residence determined?

"Each income tax year and individual's tax residency is determined by applying various criteria as specified in Australian legislation, case law and Australian Taxation Office (ATO) Taxation Rulings to the individual's past, current and intended facts and circumstances. When determining whether an individual (who has an Australian domicile) is a non-resident of Australia for Australian tax purposes, the ATO must be satisfied that:

— the individual has ceased to reside in Australia (the "resides" test); and
— the individual has established a permanent place of abode outside Australia and that permanent home is available to them at all times (the "permanent place of abode" test)."

How is tax residence ceased?

Ceased once the individual does not meet both "resides" and "permanent place of abode" tests. Each individual's facts and circumstances will differ. However, for an individual who is considered a non-resident, we often see the below major fact pattern (please note, there are various other factors to be considered also): They leave Australia for a substantial period of time (typically over 2 years), their family accompanies them, they have an established home in the foreign country, they do not have a home available for use in Australia, they do not commonly return etc.

Taxation basis for Residents

Residents are taxes on worldwide income and worldwide capital gains.

Taxation basis for non-Residents

Generally taxed on Australian sourced income and gains only (e.g. Australian investment income, bonuses or income from employee share schemes that relate to a period when the individual was working in Australia or were an Australian tax resident) and certain statutory income which is taxable on a basis other than source (e.g. capital gains tax).

ER Withholding obligation on Outbound Expatriates

Non-resident or DTA tie broken to host country – No employer withholding obligation. ***Resident*** – Depends on who the employer is. Generally, an Australian entity who pays the employee for services performed offshore would continue to have PAYG withholding obligations in respect of the individual. However, the PAYG withholding can be varied down where withholding is also implemented in the foreign country (by the amount of foreign withholding). If a foreign employer pays a Resident employee for services performed offshore then the foreign employer should not have PAYG withholding obligations, unless the foreign employer has a physical business presence in Australia.

Reliefs applicable for Outbound Expats

Non-resident or DTA non-resident – Not taxed on foreign sourced employment income.
Resident – Taxed on foreign sourced employment income, however a foreign income tax offset (essentially FTC), can be claimed in respect of double taxed income.

Methods of Claiming

Reduced PAYG withholding is allowed in respect of employment income. Final tax credits determined at year end in the tax return

Administrative Processes

Australia's filing system is based on self-assessment. However, in the event of an ATO audit, the taxpayer needs to be able to substantiate the foreign income tax offset claim. Documents that would help substantiate the claim include, foreign tax return, final withholding slips, assessment notices.

Other Comments

No present amendments anticipated

Additional notes on Residence Tests

Resides test

Generally speaking, an individual is a tax resident of Australia if they are considered to be residing in Australia. The term "reside" is not defined in Australian income tax law and therefore takes its ordinary meaning. An individual may reside in Australia if they have:

— A "continuing association" with Australia (e.g.; because spouse and children are residing in Australia and family home available for their use, family connections, location of assets and investments); and
— An intention to return to Australia at any point in the future; and
— Behaviours and attitudes that are consistent with Australia remaining as their home.

Permanent place of abode test

Whether or not an individual is considered to have a permanent place of abode outside of Australia will depend on the following factors:

— the intended and actual length of their assignment
— intention either to return to Australia at some definite point in time or to travel to another country
— the establishment of a home outside Australia
— the abandonment of any residence or place of abode in Australia
— the duration and continuity of their presence in the overseas country
— the durability of association that they have with a particular place:
— maintaining bank accounts in Australia
— sale of Australian assets (e.g. car) before departure
— place of education of children
— overseas registration for electoral roll purposes
— registration on overseas members lists of clubs and societies
— completion of immigration departure card as "permanently departing".

ANNEXURE A-3

Country: **Germany**

How is tax residence determined?

Generally, individuals are deemed to be resident - if they have a residence in Germany that they use (or that is at least available to them) or if they have a "habitual abode" in Germany. Habitual abode can be assumed if the individual is physically present in Germany for more than 6 months in any one calendar year or for a consecutive period of 6 months over a year end.

How is tax residence ceased?

Ceased once the individual does not meet the above residence tests. There are requirements to advise authorities in writing and other administrative requirements.

Taxation basis for Residents and non-Residents

Residents are taxed on worldwide income and worldwide capital gains. Other charges such as social security, inheritance tax and property taxes also apply.
Non-resident individuals are taxed (usually by withholding) on German sourced income only.

ER Withholding obligation on Outbound Expatriates

Economic Employer principals followed. Non-resident – No employer withholding obligation where duties rendered outside of Germany. Resident – Dependent on specific circumstances - typically if remaining resident the German employer continues to be obliged to withhold. Is possible in the event of DTA exemption or double taxes to apply to the tax authorities for permission to cease German tax withholding.

Reliefs applicable for Outbound Expats

Resident - employment income connected to special construction, engineering or consulting work outside Germany, lasting at least 3 months may qualify for exemption if the employee works abroad for a German employer or an employer located in the EU, and there is no tax treaty with the foreign country.
Resident – exemption with progression where exempt remuneration is taken account of in the determination of German taxes payable on other income sources.

Methods of Claiming

Cessation of payroll withholding is allowed in respect of employment income in certain circumstances. Final tax credits determined and claimed at year end in the tax return.

Administrative Processes

German tax office will typically look for proof of foreign taxes paid to substantiate any FTC claim.

Other Comments
No legislative amendments presently anticipated but recent trends have seen movement of treaty provisions away from exemption with progression to FTC basis.

ANNEXURE A-4

Country: **China**

How is tax residence determined?

"There is no specific definition of tax residence for personal tax purposes. However, the domicile concept has been adopted.

The term "individuals domiciled in China" refers to those who by reason of permanent household registration (i.e., Hukou), family ties and economic interests habitually reside in China. Overseas assignment, study, travel or visit of family member abroad do not change the status of "habitual residence in China".

How is tax residence ceased?

Not applicable.

Taxation basis for Residents

Worldwide basis. Differing rates based on source of income (up to 45% on remuneration but typically 20% on personal income).

Taxation basis for non-Residents

"For non-China domiciled individuals, China tax implication on foreign sourced income are:

- Having resided in China for one year but less than five years: foreign source income paid or borne by a Chinese entity or an individual are subject to China tax
- Having resided in China for more than five full years consecutively: world-wide income is subject to China tax from the sixth year with full year residence in China."

ER Withholding obligation on Outbound Expatriates

Employer is required to withhold PAYE on foreign sourced income

Reliefs applicable for Outbound Expats

Both domiciled and non-domiciled individuals may be able to claim a foreign tax credit on foreign service remuneration (if it was subject to tax in the foreign jurisdiction). However, the offset may not exceed the Chinese individual income tax payable.

Methods of Claiming

Individuals may claim an FTC on submission of the annual income tax return.

Administrative Processes

Monthly withholding and filing obligations by employers in regard to remuneration. Annual return only required for certain taxpayers. There is no fixed audit cycle in China.

Other Comments

Focus area of authorities is use of DTAs to obtain offshore income information of tax residents. Many recent tax circulars on high income earners (investment income and shares)

ANNEXURE A-5

Country: Hong Kong

How is tax residence determined?

No definition of residence in Hong Kong.

How is tax residence ceased?

Not applicable.

Taxation basis for Residents

"Hong Kong uses a territorial-source principle of taxation. This means that you only pay tax on income arising or derived from Hong Kong.

Salaries Tax is imposed on income arising in or derived from Hong Kong from any office or employment of profit and pensions. Citizenship, residency or domicile is generally not relevant in determining an individual's liability to Hong Kong Salaries Tax. The taxation of individual's remuneration depends on the nature of his/her employment (i.e. Hong Kong employment or Non-Hong Kong employment) as well as the days he/she spends in Hong Kong.]"

Taxation basis for non-Residents

Same as above - Territorial based system.

ER Withholding obligation on Outbound Expatriates

Not applicable.

Reliefs applicable for Outbound Expats

If the individual's remuneration in relation to his/her services rendered outside Hong Kong is chargeable to tax of substantially the same nature as Hong Kong Salaries Tax in the foreign country, he/she is eligible to claim for double tax relief in his/her HK Tax Return. Provided foreign tax has been paid, that part of the income which has been subject to both the foreign tax and Hong Kong Salaries Tax can be excluded from Hong Kong Salaries Tax.

Methods of Claiming

Return filing subject to tax authority's approval.

Administrative Processes

Return filing subject to tax authority's approval.

Other Comments

Not applicable.

ANNEXURE A-6

Country: India

How is tax residence determined?

"Tax residency is derived basis the physical presence of an Individual in India during a particular Financial Year (Period: 1 April XXXX to 31 March XXXX)

Note on residential status is attached for your reference".

How is tax residence ceased?

"Not Ordinarily Resident (NOR)
An individual who satisfies at least one of the basic conditions, but does not satisfy both of the additional conditions is treated as a NOR in India. A NOR is required to pay tax in India only on his India-sourced income.

Non-Resident (NR)
An individual is NR in India if he satisfies none of the basic conditions. In case of NR, the additional conditions are not relevant. A NR is required to pay tax in India only on his India sourced income."

Taxation basis for Residents

"For Resident and Ordinarily Resident (ROR)
As per Indian tax law, individuals who qualify as an ROR, shall be taxable on their global income. Further, they also required to report the assets held outside India in the Indian Income-tax return.

For Not Ordinarily Resident (NOR)
As per Indian tax law, individuals who qualify as an NOR, shall be taxable on their India sourced income."

Taxation basis for non-Residents

As per Indian tax law, individuals who qualify as a Non-Residents, shall be taxable on their India sourced income.

ER Withholding obligation on Outbound Expatriates

There is a requirement for the employer to withhold taxes. However, client specific analysis would be required.

Reliefs applicable for Outbound Expats

Benefits such as exemption and Foreign Tax Credit can be claimed depending upon a particular case and subject to the conditions laid down in the treaty and Indian tax law.

Methods of Claiming

"Benefit can be claimed at the time of filing of India Income tax return.
Also, there is an option to claim such benefit at the time of withholding. However, please note that this is not clearly coming from the Indian tax law. There are judicial precedents in favour and against such position. Hence, client specific analysis would be required."

Administrative Processes

"Below mentioned in the process:
- Employer needs to withhold taxes on a monthly basis and deposit with the tax authorities
- Quarterly withholding tax return needs to be filed
- Employer is required to issue annual salary certificate (I.e. Form 16 and 12BA)
- Income-tax return filing requirement (Annual)"

Other Comments

Not applicable.

ANNEXURE A-7

Country: United Kingdom

How is tax residence determined?

A Statutory Residence Test (SRT) applies

Automatically ***resident*** if present in the UK on 183 days or more.

Automatically ***non-resident*** if present in the UK for no more than 15 days (for recent residents) or 45 days (in other cases).

Can also be ***resident / non-resident*** by working full time in the UK / overseas subject to strict criteria. Can also be resident by having an only home available in the UK for a specified period. Finally, in other cases residence is determined based on a combination of UK ties and UK days of presence.

How is tax residence ceased?

Either by being **non-resident** under the SRT for the UK tax year, or if resident then by being eligible for a 'split year' of departure from the UK which is determined by reference to work or home factors.

Taxation basis for Residents

Taxable on worldwide income and gains, but if non-UK domiciled then it is possible for some forms of income to be taxable only if remitted to the UK. This can apply to employment income that is for the first three tax years in the UK.

Taxation basis for non-Residents

Taxable on UK source income only. Gains are not taxable except in relation to UK residential property. A temporary non-resident rule can apply in some cases to tax certain income and gains if a person becomes UK resident again within 5 years. Non-residents are only taxable on employment income that is for substantive UK employment duties. Most duties are considered substantive and the UK will normally apply a workday apportionment to determine the amount of UK source employment income.

ER Withholding obligation on Outbound Expatriate

No withholding is required for an employee who is non-UK resident for the full tax year if they have no UK duties. In other cases, the default position is that UK withholding is required on the full remuneration paid if the employer has a UK presence. Where the employer does not have a UK presence but the employee is UK resident for all or part of the tax year, or has UK duties, and works for another person or company in the UK then withholding is required on the full remuneration that is for the work done in respect of the UK person or company. In either case, it is possible to obtain agreement for reduced withholding where the employee is not expected to be taxable in the UK on all of their employment income for the tax year.

Reliefs applicable for Outbound Expats

Certain travel and relocation expenses are exempt if provided by or reimbursed by the employer. In other cases, some travel expenses can be claimed as a relief by the individual via a tax return if they relate to attendance at temporary workplaces. UK treaty residents can claim FTCs for foreign taxes paid on income that is taxable in the UK to the extent the foreign tax is allowed under the treaty. Where there is no treaty in place it is possible to claim an FTC for foreign tax on income that is taxable in the UK but comes from a source in the other country.

Methods of Claiming

Exempt reimbursed expenses, or travel facilities, can be paid or provided without any tax reporting requirements.

FTCs need to be claimed via the return. In some cases, advance relief can be allowed against UK withholding for overseas withholding tax.

Administrative Processes

Payroll reporting is made via a Real Time Information system whenever payments are made and withholding is remitted monthly. Personal tax returns are required in cases where there is tax to pay on items that are not dealt with via withholding, or in other cases wherever the tax authorities ask for a return to be filed. Tax equalised inbound assignees must always file a tax return. The tax return is due by 31 January following the end of the tax year (being 5 April in the previous calendar year) and the tax payment is due by the same date. In some cases, payments on account are required on 31 January in a tax year and on 31 July following the end of a tax year. Where reliefs are claimed, the refund will normally be paid shortly after the claim or return has been filed following the end of the tax year provided the tax authorities do not decide to investigate the claim or return.

Other Comments

Personal tax returns are being replaced with digital tax accounts which are intended to reduce personal tax reporting obligations by automatically collecting third party data (e.g. from employers or banks etc.). It is not expected that this will apply to expats for a number of years and it remains to be seen precisely how the new system will work for expats.

ANNEXURE A-8

Country: United States

How is tax residence determined?

"An individual can be classified as a tax resident by virtue of two tests. The first test considers if the taxpayer is a lawful permanent resident of the US (i.e. citizen) or a US Green Card holder. If true, the individual is considered a tax resident and there is no need to look to the second test. If the individual is not a lawful permanent resident or Green Card holder, he or she will be considered a tax resident if the criteria is met under the Substantial Presence Test (SPT). To meet this test, the taxpayer must be physically present in the United States on at least:

1. 31 days during the current calendar year, and
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:

    — All the days present in the current year, and
    — 1/3 of the days present in the first year before the current year, and
    — 1/6 of the days present in the second year before the current year."

How is tax residence ceased?

Under US tax law, becoming a tax resident is not in itself a taxable event

Taxation basis for Residents

Worldwide basis

Taxation basis for non-Residents

US Source income (wages from US workdays, US ordinary dividends, US rental income, other US business income)

ER Withholding obligation on Outbound Expatriates

An employer does not have to withhold U.S income taxes and wages the employee earns abroad if it is reasonable to believe that this will be excluded from income under the foreign earned income exclusion or the foreign housing exclusion.

Reliefs applicable for Outbound Expats

Individuals are afforded relief via the foreign earned income and housing exclusion. However, the relief is not unlimited. It is capped at an annual amount. For 2016 the relief was approximately $115,000 for individuals resident in South Africa (outside of Pretoria). For income above the exclusion amount the individual may claim a credit for foreign taxes imposed on that income.

Methods of Claiming

Generally, an employer can stop the withholding once an employee submits the statement indicating that they expect to qualify for the foreign earned income exclusion under either the bona fide residence test or the physical presence test and indicating their estimated housing cost exclusion.

Administrative Processes

US Citizens are required to submit Form 673 as a statement that they will meet the foreign earned income exclusion. Non-U.S. citizens do not have to use the form. However, they can prepare their own declaration

Other Comments

Not applicable.

ANNEXURE B

List of countries with no/low income tax:

Please click here to view List of Countries with No/Low Income Tax

ANNEXURE C

DISCUSSION REGARDING BREAKING OF TAX RESIDENCY

1. Tax Residence for Outbound Expatriates

Since 2001 South Africa has taxed individuals on a residence basis. S1 of the Income Tax Act defines a resident as a person who is "ordinarily resident" of South Africa or a non-resident who has been in SA a required number of days. Therefore, tax residence of natural persons is determined based on two tests –

- Physical Presence Test and
- Ordinarily Resident Test

A person is considered resident under the physical presence test for a year of assessment if, in respect of that year, that person spends or has spent the following periods of time in South Africa:

- More than 91 days in aggregate in the year of assessment under consideration; and

- More than 91 days in aggregate during each of the five years of assessment preceding the year of assessment under consideration; and

- More than 915 days in aggregate during the five preceding years of assessment.

An individual has to meet all three requirements before he or she is considered tax resident under the Physical Presence Test for a particular year of assessment.

Ordinarily resident has not been defined in legislation but is considered to be where an individual has their permanent or true home – it is not determined based on days spent in the country. Courts have held this to be the place to which a person returns after their wanderings and where their permanent place of abode is. Temporary and occasional absences from this place of abode does not impact this determination of the ordinarily resident status of the individual. It is both intent and actions which impact a determination of a person's ordinarily resident status.

SARS interpretation note on ordinarily resident indicates a large number of factors which would be considered when determining the ordinarily resident status of an individual including

- Habitual abode
- Place of business/interests
- Status in countries
- Family and social links
- Frequency and purpose of travel

Where a person is resident under either of the above tests they are considered to be tax resident of South Africa (subject to Double Taxation Agreement considerations discussed later).

In general, for outbound expatriates on fixed term contracts, with an intention to return back to South Africa they would be viewed as remaining ordinarily resident of South Africa, as both intent and actions would point toward a continuation of ties to South Africa.

Individuals making permanent moves from South Africa with no intention to return back to the country may potentially cease their ordinarily resident status on departure from the country. This would be dependent on specific aspects of their case such as cessation of ties, location of assets, immigration status, formal emigration etc.

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2. Scope of Taxation

Individuals considered to be tax resident of South Africa are subjected to taxation on worldwide income and worldwide capital gains.

Non-Residents are subjected to SA taxes on South African sourced income and on capital gains arising on the sale of –

- Immovable property in South Africa or
- Right or interest in immovable property in South Africa or
- Assets connected with a South African PE of the non-resident person

In regard to remuneration, SA tax residents remain taxable in SA on worldwide remuneration, regardless of where this remuneration is paid from, unless the conditions of exemption under S10(1)(o)(ii) of the Income Tax Act are met.

Non-residents are subjected to SA taxes on remuneration sourced in South Africa. Remuneration is deemed to be sourced in the country in which the services are rendered.

Domestic legislation provides foreign tax credit relief for foreign taxes suffered by a resident on foreign sourced income taxed in South Africa.

3. Cessation of Tax Residence

South African tax resident individuals can cease tax residence under the following scenarios –

- By no longer meeting both the Ordinarily residence and Physical Presence Test or
- By becoming an exclusive treaty resident of a country with which we have double taxation agreement

Cessation of residence for persons not ordinarily resident through no longer meeting SA residence requirements requires the individual no longer fulfilling the physical presence test. A person would cease residence under the Physical Presence test on the date of departure from South Africa if they remain outside of South Africa for a continuous period of at least 330 consecutive days**.** If the 330-day test is not met then they will be not resident from the beginning of the tax year in which the requirements of the physical presence test are not met. The above however would only be a consideration where the individual is not ordinarily resident of South Africa.

In order for such an ordinarily resident cessation it would require a long term, if not permanent, cessation of links to South Africa. This would generally occur where the individual is permanently departing from South Africa with no intention to return back to the country. For example, this may be applicable for a person who formally emigrates from South Africa, disposes of all SA assets (e.g. property, retirement savings etc.) and is departing under a permanent contract.

While a significant portion of outbound individuals working abroad would do so on a fixed term contract basis with a long-term intention to return back to South Africa, a growing portion of South African’s leaving the country to work abroad are doing so without an intent to return back to South Africa and may be ceasing SA tax residence, under both physical presence and ordinarily resident on their departure from the country.

Given that accounting firm involvement in providing tax support is often restricted to assignee movement (intra-company or permanent hires) for large corporations a determination of the percentage of individual's leaving outside of large corporate networks is difficult.

Where expatriates depart South Africa either on an assignment or permanent transfer basis to a country with which South Africa have a double taxation agreement, there is a strong possibility of cessation of tax residence under the application of such a treaty. This would occur where the individual becomes an exclusive treaty resident of their host country (under Article 4 of the Double Taxation Agreement) and, as a result, are automatically treated as being a non-resident of South Africa under the Income Tax Act regardless of whether they otherwise are resident under the physical presence or ordinarily residence tests.

In order for an individual to be treaty resident of another country they would be required to be –

- Tax resident in the host country and
- Deemed to be exclusively resident in the host country on application of the "tie-breaker" clauses as set out under Residence Article (Article 4) of the relevant double taxation agreement.

Determination of country of treaty residence can be complex and requires a detailed consideration of the personal circumstances of the individual.

Under the first of the tie breaker tests an individual is considered to be exclusively tax resident of the country where they have a permanent home available to them. The OECD Model Tax Convention commentary states *"it is considered that the residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as oppose to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration"*.

The commentary goes on to place importance on the permanence of the home, stating that *"this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay".*

For South African outbound assignees who no longer have an SA residence available to them, having either sold or rented out their primary residence, they will likely be in a position of no longer being viewed as having a permanent home continuously available to them in South Africa. As such individuals will invariably have a permanent home available to them in the host country (being a rented property in the host location, as ownership is not a requirement in order to have an available home), SA long term outbound individuals will cease SA tax residence should they not retain a permanent home in SA.

In the event of the first tie breaker test being indecisive, either through there being a permanent home in both or neither state, it is necessary to consider the next test – being where the personal and economic ties of the individuals are closer (centre of vital interests).

Determination of a country of treaty residence under the centre of vital interests test requires examination of the individuals overall circumstances including where his family and social links are located, where his occupation is carried out, where assets are located etc. SA outbound expatriates who move abroad with their family, are employed/remunerated abroad and cease a number of ties with SA may be potentially viewed as ceasing residence under this test.

If the above test is not conclusive, habitual abode followed by nationality are considered. In the event of the lack of a conclusive result the treaty resident status of an individual would be required to be solved by mutual agreement between the States. It could be anticipated that in the event of an amendment to S10(1)(o)(ii) there would be an increased number of expatriates who will seek to be treated as non-resident of South Africa in order to meet exemption from SA taxation on remuneration, and thus a greater volume of SARS time will need to be spent in the analysis of treaty residence determinations.

In summary, it is possible for outbound South African resident expatriates to cease SA tax residence under the DTA provisions even where there is a long-term intention of the individuals to return to South Africa and where they would otherwise remain SA tax resident under either the Physical Presence or Ordinarily resident tests. This may be more desirable to expats in the event of legislative change, even though this may give rise to additional taxation due to the deemed disposal of assets on cessation of tax residence.

4. SA Treaty Network

South Africa has an extensive network of over 70 Double Taxation Treaties, covering both Africa and the rest of the world. The domestic personal income tax rates within those countries vary significantly – from 0% (e.g. Kuwait, Qatar, Oman, UAE, Saudi Arabia) to over 60% (e.g. Sweden).

For individuals who leave SA on long term assignments or as permanent transfers they will likely trigger domestic tax residence in the host country (depending on the local determination of tax residence). As a result, a cessation of residence under the tie-breaker clauses will occur where the individual becomes treaty resident of the host country.

The determination of residence in each country is dependent on the domestic laws applicable. Generally, presence over 183 days per annum (sometimes with some additional longer intention) can be sufficient for a country to treat an inbound individual as tax resident.

5. Implication of Cessation of Tax Residence

Where individuals cease to be SA tax resident they are treated post-date of cessation as a non-resident and thus subject to SA taxes on South African sourced income from that date. As a result, remuneration for services rendered outside of SA, foreign personal income (e.g. non-SA interest and dividends) and certain SA sourced personal income (depending on treaty provisions) will be outside of SA taxes post-date of cessation of residence.

In regard to capital gains, a non-resident is subjected to capital gains arising on the sale of immovable property. The cessation of residence results in a deemed disposal of worldwide assets, a "CGT Exit Charge", under the terms of Paragraph 12 of the 8th Schedule of the Income Tax Act. For typical outbound assignees who cease SA tax residence the following is the main asset types which are deemed disposed of –

- Local and foreign share holdings
- Unit trusts
- Foreign property

— Interest in a cc or trust

For individuals who have not had significant accumulation of worldwide assets to date of departure the above exit charge would have minimal impact. This is seen with individuals at junior to middle management levels where the full extent of worldwide assets would typically consist of an SA property, interest income and retirement savings which would not be impacted by the exit charge.

Following the breaking of tax residence, the accumulation of worldwide assets (excluding SA property) during their time abroad will be outside of the SA tax net. Therefore, this period where individuals will often start to accumulate non-SA assets and have a broader investment base will be a period where there is no accumulation of SA capital gains. These assets will, under Paragraph 12(2)(a)(i) of the 8th Schedule, be revalued for base cost purposes at the market value at the time that the person becomes tax resident once again in South Africa.

For senior individuals who have extensive worldwide assets at time of cessation there can be a considerable CGT exit charge created. This can result in significant taxes arising on deemed disposal of assets. Where the assignment period abroad is relatively short (e.g. 1 to 2 years) this exit-charge can represent a significant financial and cash flow burden. In such circumstances, actual disposal of the assets may e preferred to provide cash to pay the taxes due. It should be noted that some other countries, for example Australia, have an option for individuals to elect out of an exit charge and defer CGT to time of disposal.

Where the period abroad is longer term, expatriates can often benefit significantly in terms of the growth in the value of worldwide assets during the period of non-residence. Thus, suffering the exit charge on departure (or actual disposal pre-cessation of residence) can be in the longer-term interests of the expatriate. As such we would not view the CGT exit charge as being a deterrent to the majority of senior expatriates as the benefit of SA capital gains free uplift of worldwide assets for the period abroad would outweigh the short-term CGT on departure from South Africa.
In the event of the introduction of amendments to S10(1)(o)(ii) it is possible that an increased number individuals will actively take steps which may trigger a cessation of tax residence under a treaty (e.g. by ensuring that they do not have a permanent home available in SA or that their personal and economic ties are closer to the host country). Even where a treaty is not in place there may be circumstances where expatriates would look to break ordinarily resident links to South Africa and put in place permanent ties in foreign countries in order to avail of remuneration exemption presently afforded under S10(1)(o)(ii), but potential restricted in the event of legislative change.

In the event of amendment of the current S10(1)(o)(ii) exemption it could result in outbound expats to non-treaty countries being significantly adversely impacted to counterparts who are working in treaty countries.

It should be noted that there is a portion of expatriates who continue to file as SA tax resident during their time abroad even in cases where they are likely non-resident. This is often driven by a desire not to trigger the CGT exit charge (due to cash flow considerations) but also often out of ignorance of SA tax residence rules. As a result, worldwide personal income and worldwide capital gains continue to be disclosed annually. An adverse amendment to S10(1)(o)(ii) could see a greater focus of these expatriates on their residence status and thus a larger proportion of non-resident filings.

6. Other Considerations

Aside from income tax and capital gains being impacted by tax residence status of individuals there is also impacts either under domestic legislation or under application of the treaty on income sources such as –

- Taxation of pensions
- Taxation of inheritances/estates
- Taxation of donations

Future potential legislative amendments such as land tax and wealth taxes could also be impacted.

7. Summary

In summary, it would be anticipated that any significant amendment to the current benefits of S10(1)(o)(ii) would see a rise in number of expatriates looking to cease SA tax residence. This cessation would typically be under the tie-breaker clauses (where resident of a treaty country) or cessation of physical presence and ordinarily resident status (where there is no applicable treaty). As discussed, the cessation of residence under a treaty can be achieved often relatively easily, depending on personal circumstances.

While a short-term benefit may arise in terms of the CGT exit charge on cessation of residence, there will be a loss in future revenue due to accumulation of assets during the time of non-residence being excluded from SA taxes. There would also be losses arising from taxes on personal income no longer taxed in the hands of non-residents.

There would be an increased need for SARS skills and resources in examining an increased number of residency determinations, which up to now has not been as significant due to the provisions of S10(1)(o)(ii).

ANNEXURE D

DESCRIPTION OF HOW EXPAT TAX POLICIES WORK AND THEIR IMPACT ON THE EMPLOYER, EMPLOYEE AND PROJECTS – TAX EQUALISATION AND TAX PROTECTION

1. Tax equalisation

1.1 What is tax equalization?

The purpose of a Tax Equalisation policy is to ensure that an employee undertaking an international assignment is not in a better or worse financial position as a result of the international assignment. Tax equalisation ensures that the assignee bears approximately the same tax liability that he would have paid had he remained in his home country.

1.1.1 How does Tax Equalization work?

There are four basic elements to Tax Equalization:

1. **Hypothetical tax:**

   Hypothetical tax is a notional amount which is equivalent to the estimated tax liability that an employee would have paid on his income in his home country, in the absence of an international assignment. The hypothetical tax is taken into account in determining the amount of remuneration that the assignee is entitled to receive i.e. the assignee's remuneration is reduced by the amount of hypothetical tax calculated by the employer as he is not entitled to this amount.

   Note that the amount of hypothetical tax for which the employee is liable is generally calculated on the employee's employment income only; however, an employer may choose to tax equalise a limited amount of personal income as well.

   The employer is liable to pay any home and host country tax liabilities that arise, which exceed the assignee's hypothetical home country tax liability.

2. **Home country tax:**

   The actual income tax liability (if any) payable to the South African Revenue Service ("SARS") in respect of the assignee's income.

3. **Host country tax:**

   The actual income tax and social security contributions payable in respect of the assignee's income to the host country revenue authorities.

4. **Tax equalisation calculation:**

   The year-end calculation of the expatriate employee's stay-at-home tax liability based on actual income and deductions (excluding any assignment related allowances and benefits).

1.1.2 The practical implementation steps:

A hypothetical tax liability is calculated on the assignee's income in accordance with the applicable home country marginal tax rates. When calculating the amount of hypothetical tax, assignment-related allowances and benefits (such as a cost of living allowance or an accommodation benefit), are excluded from the assignee's income i.e. only income that he would have received in the absence of the international assignment is taken into account.

The assignee's earnings are reduced by the amount of hypothetical tax when calculating the amount that he is entitled to receive on a monthly basis. It is important to note that the assignee is not entitled to the amount of hypothetical tax calculated and therefore this amount does not accrue to him.

Since the amount is not actual tax it is not paid over to SARS unless this is required by law e.g. if the section 10(1)(*o*)(ii) exemption will not apply. As mentioned, the employer is liable to pay any home and host country tax liabilities that arise, which exceed the assignee's hypothetical home country tax liability.

At the end of the tax year, the assignee's home and host country income tax returns are prepared and thereafter the assignee's stay-at-home tax liability is calculated (excluding assignment related allowances and benefits). If the assignee's stay-at-home tax liability is more than the hypothetical tax liability that was calculated at the beginning of the tax year, he will owe the company the difference. If the assignee's stay-at-home tax liability is less than the hypothetical tax liability that was calculated by the company, the company will owe the assignee the difference.

The above mechanism ensures that the assignee continues to bear the same tax liability that he would have paid had he not taken up an international assignment i.e. the assignment is tax neutral for the employee.

Example:

A South African employee is sent on an international assignment to Botswana. At the beginning of each tax year the assignee's hypothetical tax liability is calculated based on South African tax rates, to determine the amount of tax that he would have paid on his income had he not taken up the assignment in Botswana. The assignee's earnings are reduced by the amount of hypothetical tax calculated, as the assignee is only entitled to an amount net of hypothetical tax. Note that for ease of reference this reduction in pay may be reflected as a monthly hypothetical tax deduction on the employee's payslip.

The employer pays the assignee's tax liability in Botswana. An additional taxable benefit will arise in the employee's hands as a result of the payment of the employee's tax liability by the employer. The employee's income must therefore be grossed up to account for the tax-on-tax effect and the employer will pay the tax in Botswana on the employee's grossed up remuneration.

At the end of the tax year, the assignee's stay-at-home tax liability is calculated including all income that he actually received (for example, bonuses which may not have been taken into account when calculating the assignee's hypothetical tax liability), as well as any allowable deductions. Note that assignment related allowances and benefits are excluded from this calculation.

The tax liability calculated on the assignee's stay-at-home income is then compared to the hypothetical tax that was calculated at the beginning of the year. If the hypothetical tax is insufficient to cover the assignee's stay-at-home tax liability the assignee will be required to pay the difference to the company. If the assignee's remuneration was reduced by too much hypothetical tax the company will need to reimburse the difference to the assignee. This is known as a tax equalisation settlement.

The amount reimbursed by the employee or the employer (as the case may be) as a result of the tax equalisation settlement process, will be taken into account when preparing the employee's income tax return for the tax year in which the tax equalisation settlement occurs.
As the employer is responsible for paying the assignee's actual tax liabilities in the home and host countries, any refunds payable by SARS or the Botswana revenue authorities will be due to the employer.

2. Tax Protection

2.1 What is tax protection?

Tax protection is similar to tax equalisation in that the intention of a tax protection policy is to ensure that the employee is not negatively impacted from a tax perspective as a result of a foreign assignment.

Tax protection comprises the following steps:

- A hypothetical tax liability is calculated based on home country tax rates but the assignee's pay is not reduced by this amount.
- The assignee pays his own tax liabilities in the home and host countries.
- The assignee's total tax liability (home and host country) is compared to his home country hypothetical tax liability.
- The employer reimburses the employee the amount by which his total tax liability exceeds his home country hypothetical tax liability.

Under a tax protection policy, the employee's hypothetical home country tax liability is calculated by the employer but the amount is not retained by the employer. The employee remains liable for both his home and host country tax liabilities, however, he is assured that he will not suffer a tax burden which is higher than his hypothetical home country tax liability.

To the extent that the employee's actual home and host country tax liabilities for the tax year exceed his hypothetical home country tax liability, the employer will perform a tax settlement calculation to determine the amount to be reimbursed to the employee.

Since the amount reimbursed to the employee constitutes additional remuneration in the employee's hands, the amount will be included in his income tax return for the tax year in which the settlement occurs. In order to ensure that the employee receives the correct net payment, the amount will be grossed up to account for the tax payable by the employer on the reimbursement.

Under a tax protection policy, where the employee is seconded to a low-tax jurisdiction, the tax benefit is enjoyed by the employee.

3. Impact of Tax Reimbursement Policies on Employee, Employer and Projects

3.1 Reasons for implementing a tax reimbursement policy

3.1.1 Encourage international mobility

Employees, particularly in the mining and construction sectors, are sometimes required to relocate to less developed countries or to a remote location within a country where infrastructure is lacking and there are very few amenities. The expatriate employees are sometimes provided with very basic accommodation which they are often required to share with other assignees. Due to the lack of appropriate facilities, the expatriate employees' families are often required to remain at home in South Africa. Companies wishing to second employees from South Africa to less developed countries or remote locations sometimes struggle to convince employees with the appropriate skills to relocate to these countries. Consequently, the company will seek to compensate the employees by offering a remuneration package which is attractive. A component of this is providing tax assistance to the expatriate employees who now need to manage their tax affairs in two different countries. A tax reimbursement policy removes the need for the employees to consider the tax consequences of the assignment when deciding whether to accept or decline the foreign assignment.

The cost to the company of doing business would take into account, *inter alia*, the tax cost to the company and any savings that can be derived through tax concessions offered in the home and host countries (for example the section 10(1)(o)(ii) exemption). Should these tax concessions subsequently be removed, the cost to the company is likely to increase significantly.

3.1.2 Need for fair and consistent approach

Assignees pays no more and no less tax than their counterparts in the home country ("assignees are no better or worse off")

3.1.3 Taxation in host country versus home country

- Host country may or may not tax the same items of income in the same fiscal year.
- Different tax rates, allowances and deductions may apply.
- There may be preferential tax treatment for some benefits in kind.
- There may not be comparable tax treatment in the host country in relation to certain items (e.g. home country pension fund contributions).
- Assignee receives taxable compensation while on assignment that he would not otherwise have received. Consequently, he will have more tax to pay than he would have paid had he remained at home.

3.1.4 Promotes compliance

Actual home and host country tax liabilities are the employer's responsibility. Furthermore, tax compliance services are often outsourced to a service provider.
The expatriate employees do not have a direct interest in how their host and home country tax liabilities are determined nor the quantum thereof.

3.1.5 Overwhelmingly accepted norm by global companies

ANNEXURE E

PRACTICAL IMPLICATIONS OF ADMINISTRATION OF FTC'S

1. Foreign Tax Credits (FTC)

Our comments mainly relate to FTC's claimed in South Africa by employees who are sent by their employers on assignment to foreign (host) jurisdictions. Some of these comments would similarly also apply to South African tax resident individuals who find their own employment in foreign jurisdictions.

2. When is the FTC claimed

- A foreign tax credit will be applied in terms of section *6quat,* where the assignee has not met the foreign income exemption in terms of section 10(1)(o)(ii) and the assignee is subject to tax on the same foreign-sourced income in both South Africa and the host jurisdiction;
- A foreign tax credit may be claimed where the assignee is taxed as a resident in the host jurisdiction and in South Africa as well. World-wide personal income will be taxed in both home and host jurisdiction (in the case of dual-residents).
- The assignee may remain on the South African payroll and South African retirement fund, while on assignment outside South Africa, therefore, monthly PAYE will continue to apply in South Africa. Employees' tax may however, also be applicable in the host jurisdiction.

3. Assignees who are tax equalised

- As discussed under point 4, where the assignee is tax equalized, the employer will bear the cost of any additional tax liability.
- The assignee's remuneration is reduced by a hypothetical tax and in return the employer will pay the taxes in the host country.
- Generally the assignees are provided with various assignment benefits and allowances which are included in the taxable income of the assignee in the host country. Generally the employer also bears the tax on these benefits.
- Where the employer assigns the employee to a low tax jurisdiction, the tax cost in the host country is reduced due to the lower tax rate, which can be illustrated by the following example:

  Employee's gross assignment salary = R 3,000,000
  Hypothetical tax – R 1,194,990
  Net assignment salary – R 1,805,010
  Assignment benefits – R 1,000,000
  Total assignment remuneration – R 2,805,010
  Tax rate in host country - 20%
  Tax liability in host country (with gross-up) – R 701,253
  Tax liability in South Africa (s10(1)(o)(ii) exemption applies) – R 0
  The total employment cost in respect of the assignee is therefore R 3,506.263

- If the exemption no longer applies, the total employment cost will be as follows if the employee remains in the same position.

  Employee's gross assignment salary = R 3,000,000
  Hypothetical tax – R 1,194,990
  Net assignment salary – R 1,805,010

Assignment benefits – R 1,000,000
Total assignment remuneration – R 2,805,010
Tax liability in South Africa (with gross-up) – R 2,013,172
Tax liability in host country (with gross-up) – R 701,253
Provided that an FTC will be given for the host country tax it will be a temporary cost at most
The total employment cost in respect of the assignee is therefore R 4,818,182.

- The total employment cost therefore increases with R 1,311,919.
- Ultimately any change in legislation which impacts the cost of the assignment will in turn impact the cost of any project and foreign investment made by a South African entity.

4. Claiming FTC in payroll

- Currently the legislation doesn't allow for the FTC to be applied in the payroll. In order for the employer to allow the FTC in the payroll it has to apply for a tax directive from SARS. Previously it was understood that the legislation would be amended to allow the employers to allow the FTC in the payroll, but the provisions were removed from the final legislation.
- This creates another issue as the employer then has to pay the tax in the foreign country which then creates another tax liability in respect of interest free loans if no interest or low interest is charged on this amount, which further increases the cost of the assignment.

5. Process of claiming foreign tax credits

- A South African tax return does not make provision on the return to claim foreign tax credits, unless it is indicated in the return that the employee earned foreign income and an amount of foreign income is included in the tax return. The fact that the foreign source codes are used in the IRP5 tax certificate does not allow the taxpayer to claim the foreign tax credit.
- The taxpayer should therefore report R1 under the foreign source code in order to be allowed to claim the foreign tax credit in the return. This is not correct but the only practical way in which to claim the FTC if the foreign income is reported in an IRP5 tax certificate.
- If this is not done, the FTC can only be claimed through an objection.
- The objection is prepared with the following supporting documentation:

  - Copies of passport and travel calendar's;
  - Proof of tax paid in host jurisdiction, including either employees' tax or tax paid on assessment.

- Once objection is received by SARS, in most cases further requests for information are requested by SARS assessors.
- Where the assignee has a refund due to him as a taxpayer, the tax is often due back to the employer as the employer has covered the double tax burden.
- The claiming of the FTC on assessment will significantly increase the number and the value of the refunds due to taxpayers.
- SARS has a specific process to repay any refunds:

  - The refund is subject to an audit, once the objection has been approved;
  - Once the audit is concluded and the refund approved, the SARS accounts team then initiates a further audit.

- A refund of foreign tax credit may take up to 3 years to be received by the taxpayer or his/her employer.
- The additional work that has to be performed by the tax service providers in respect of the claiming of the FTC and refunds will further significantly increase the cost of the tax services in respect of expatriate employees.

6. Timelines

Different countries have different tax periods, as an illustration:

- The UK tax year is from 6 April to 5 April the following year, therefore, any foreign tax credit claimed in South Africa would be claimed in respect of the period April to February of the UK tax year. Tax in respect of March can only be claimed in the following South African tax year.
- Difficulties arise in being able to prove to SARS the tax paid in the UK as the proof of payment is in respect of a different period. There is no standard process or guidance of apportioning the tax paid and often creates additional objection process.
- Proof of tax paid may not be available in the filing period being submitted in South Africa. As an illustration:

    - The tax year in Italy is from January to December, however, the filling season for that calendar year is only initiated in June of the following year, therefore, proof of tax paid may not be available on-time to submit with the South African tax objection process, and special permission needs to be requested for the late submission of an objection.

7. Countries where payroll is the final tax

Some countries in the African region do not have an assessment process, as payroll is the final tax. As an illustration:

- Nigeria-tax is paid on remuneration as employees' tax withholding on a monthly basis.

    - The only proof of tax paid is a stamped excel type schedule presented at a bank in Nigeria, with all the employee's names.
    - This proof of payment is not always recognised by tax assessors in South Africa, and various objections have to be initiated.

8. Conclusion

Should the section 10(1)(o)(ii) exemption be repealed, there will be a significant increase in the number of taxpayers who will be entitled to and relying on claiming FTC's. This will increase the administrative burden on employees, employers and SARS. The increased burden and cost of administration should not be underestimated. The claiming of FTC's is not a simple automated process. The problems and time delays already experienced by taxpayers to receive the FTC's that they are entitled to should be taken into account and a more effective solution should be aimed for.