

Expat tax and residency

South African tax residents working abroad are thinking twice whether to remain a South African tax resident or not. This is after the amendment of the foreign employment exemption in section 10(1)(o)(ii) of the Income Tax Act in 2017, an amendment that limits this exemption, commonly referred to as “Expat tax”.

The effective date of the amendment is 1 March 2020.

Why the change?

The exemption was introduced in 2001 to eliminate double taxation when a South African taxpayer works abroad. At the time the country didn't have many double taxation agreements (DTAs) with other countries, but currently there are 78 DTAs and so the risk of double taxation is much lower.

One of the main driving forces behind the amendment was the double-no-taxation instances that arose where a South African tax resident works in a tax-neutral jurisdiction and therefore no tax being paid in the host country and no tax paid in South Africa.

The amendment focusses mostly on the person working and earning an income abroad, but doesn't contribute to the tax base supporting the life that their family – who remains in South Africa – enjoys.

The current position

South African tax residents working abroad enjoy an income tax exemption for all foreign employment income earned abroad. This is the case as long as they are physically outside the country for more than 183 days during any 12-month period, of which more than 60 days are consecutive. The following example will illustrate the exemption:

Jackson is a pilot and works abroad. He has been working in Dubai. His income for the year is R1 550 000 and he also enjoys fully paid for accommodation, meals and transport, valued at R250 000 per annum.

During the last 12 months he only returned home for his father's 70th birthday party – which took place over a week in November and he returned for a break of three weeks in January.

He did not earn any additional income during the year.

For the tax year ending 2019, his total income of R1 800 000 will be exempt from income tax in SA due to the provisions contained in section 10(1)(o). No tax is paid in Dubai.

'Expat tax' day – 1 March 2020

The amendment introduces a cap to the exemption. It determines that the first R1 000 000 of foreign employment income earned during the tax year will be exempt from income tax. If we consider Jackson's situation from 1 March 2020, the tax situation at the end of that tax year will be as follows:

Total income earned	R1 800 000
Less exemption	R1 000 000
Taxable income	R800 000
Tax payable*	R230 820

(*Based on the 2019/20 tax rates.)

Therefore his net income will reduce from R1 800 000 to R1 569 180.

Will residency status have an impact?

Residency – specifically tax residency – will have an impact on the effect of this amendment. If a person works and earns income abroad and is a tax resident in South Africa, that person will be taxed on their worldwide income in South Africa and the R1 000 000 exemption will apply in respect of foreign employment income. The foreign employment income earned in excess of this amount will be subject to normal income tax in South Africa.

Resident for income tax purposes

In terms of the Income Tax Act, a natural person is resident for income tax purposes if the person:

- Is ordinarily resident in South Africa; or
- Meets all the requirements of the physical presence test; and
- Is not deemed to be exclusively a resident of another country for the purposes of the application of any tax treaty.

The concept of 'ordinarily' resident is not defined in the Act and the requirements to fulfil this test have developed over many court cases. The concept of 'ordinarily' resident is the first test conducted during a tax year to determine a person's tax residency and only if a person is not ordinarily resident during a tax year, is the physical presence test done.

The ordinarily resident test is a factual test and considers all the facts and circumstances of each individual. It determines that if the person considers South Africa to be their home – where they would return to from the worldwide roaming – then that person is a resident for tax purposes.

Factors that can be considered include the following:

- The most fixed and settled place of residence
- The habits and mode of life
- The location of the workplace, interests and personal belongings
- The status of the person in South Africa and the other country – did they emigrate or immigrate, are they working on a work permit, and what are the conditions, etc.;
- Nationality;
- The person's application for permanent residency or citizenship; and
- Periods abroad, reasons to visit South Africa and the frequency of those visits, etc.

This list is not exhaustive, serves as a guideline and shows that all factors are considered when applying this test.

The physical presence test is based on the amount of time a person is in South Africa during the year of assessment (tax year) and also during preceding tax years. This test is only conducted if the person is not ordinarily resident during that tax year. The requirements refer to the number of days that a person must actually be present in the country during a tax year and also during the five tax years preceding the year under consideration.

Based on this test, a person is a South African tax resident and liable for income tax on their worldwide income in South Africa if they are physically present in the country for a period or periods exceeding –

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

If a person, who is a resident, is physically outside the country for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present, that person's tax residency is deemed to have ceased on the day that they left the country.

It is important to remember that a natural person who is ordinarily resident, spending time outside the country and who intends returning is regarded as a tax resident regardless of the period of time spent outside the country.

Residency for exchange control purposes

A person's residency status for exchange control purposes is not relevant when considering the impact of this amendment to the exemption, however, it is a factor to consider when determining if someone is ordinarily resident when determining tax residency, and therefore it is worthwhile giving it an overview.

A resident for emigration purposes is defined in the Currencies and Exchanges Manual for Authorised Dealers as follows:



"Resident means any person (i.e. a natural person or legal entity) who has taken up permanent residence, is domiciled or registered in South Africa."

It is not based on citizenship but rather where a person resides on a permanent basis. There are essentially four types of persons recognised by the South African Reserve Bank (SARB) for exchange control purposes:

- SA resident living in SA;

- SA resident temporarily abroad – living abroad and working abroad but no formal emigration process followed;
- Non-residents – those who have formally emigrated from SA; and
- Non-residents – those that were never a resident in SA (example: working on a temporary work visa).

A South African resident temporary abroad will be seen as a resident for exchange control purposes, even if that person has taken up foreign citizenship.

It is clear that a person who is a resident for exchange control purposes is not necessarily a resident for tax purposes and vice versa. The outcome is that one cannot simply say that a person will cease to be a tax resident if that person emigrates – there is more to shedding tax residency than merely following the emigration process.

Financial emigration – the light at the end of the tunnel?

While financial emigration is 'marketed' as the beacon of hope and the only way to get around the amendment, it is not necessarily true for all.

Financial emigration is where the South African resident, temporarily abroad, formally emigrates. Up to now, this has been a process followed with the main purpose to access and transfer all South African funds abroad, particularly those in retirement annuities (and now also preservation funds), prior to retirement.

Will financial emigration result in a change in tax residency? Not necessarily. As indicated above, emigration is one of the factors – not the only one – that is considered when determining if a person is ordinarily resident.

Sars Interpretation Note 3, issued on 20 June 2018 and dealing with the ordinarily resident definition, states the following:

"Generally, if a natural person emigrates from the Republic to another country, that person ceases to be a resident of the Republic from the date that person emigrates."

From a practical perspective, when a person completes the emigration process, they will no longer be a resident for exchange control purposes and it is likely that it will result in them no longer being ordinarily resident in South Africa due to their intention to leave the country permanently.

That will result in the physical presence test being applied in that following tax year to determine if they are still a resident for tax purposes. If they are absent from South Africa for 330 days over the two years, they will no longer be a South African tax resident. The effective date will be the date on which emigration took place.

From that date, worldwide income will no longer be subject to income tax in South Africa – only income from a South African source will still be subject to tax in the country – subject to the provisions of any double taxation agreement that may exist between South Africa and that relevant country.

Can a person 'hide' from the consequences of this amendment?

The next question is 'How will Sars know that I am earning income abroad?'

Firstly, Sars probably already knows about the income, as a tax resident earning income abroad, the taxpayer would have completed tax returns each year and relying on the section 10(1)(o) exemption and therefore paying no tax on the foreign employment income. It will not be possible to just disappear from the tax radar – and therefore Sars will now.

In addition, the world is sharing data in terms of many international treaties and therefore it is highly unlikely that someone will be undetectable.

Consult an expert

Another round of discussions took place to consider the impact of the amendment. Sars and Treasury remain steadfast in the plan to implement the amendment and therefore the current status is that its implementation will go ahead.

It is obvious that many people will consider formal emigration as a prevention method when faced with expat tax. However, it is important that experts are consulted to determine what the best course of action in a specific situation would be.

Before making the final decision to change tax residency, the actual implications of that decision should be considered, and only once all the facts are on the table can an informed decision be made. The following article will highlight the most pertinent consequences when changing one's residency status for tax purposes.

Emigration and a change in resident status and financial planning

In the light of the amendment to the foreign employment income exemption, many taxpayers are considering changing their tax residency.

The amendment will have the largest impact on South Africans who are abroad temporarily. It generally includes those who left South Africa for attractive career opportunities or those planning to relocate, but first testing the water. In most cases they didn't consciously decide to end their South African tax residency status and didn't emigrate formally either. Their assets remained in South Africa without any real consequence or plan.

What happens if tax residency changes?

When South African resident taxpayers become non-resident for tax purposes (doesn't meet the ordinarily resident or physical presence tests) they may become liable for capital gains tax (CGT). If a person stops being a resident, the Income Tax Act treats it as a deemed disposal of all assets.

When a person is no longer a tax resident, it is deemed that all assets are disposed of the day immediately before the cessation of residency. It is treated as if those assets are disposed of at market value on that day and then bought again at market value (which will be the new base cost when the asset is eventually sold).

The only exception to this rule is immovable property. The Act determines that immovable property won't be included in the deemed disposal provision as non-residents are still liable for CGT when selling property anyway.

The following example illustrates this:

Johanna moved to Dubai and has been working there full time. She returns to South Africa each year to visit family and friends and to consult with some of her old clients.

Due to the introduction of expat tax, and because she wants access to her retirement annuity, she has decided to formally emigrate.

She has also decided to break her working relationship with her South African clients. She has no intention of returning to the country and is not an ordinarily resident of South Africa any longer. The physical presence test has to be done to determine residency, and based on the test, she is no longer a resident for tax purposes.

Her assets are as follows:

Asset	Market value	Base cost
Fixed property	R3 000 000	R1 900 000
Share portfolio	R2 400 000	R1 000 000
Unit trust investment	R1 500 000	R1 000 000
Retirement annuity	R1 000 000	N/A

Note:

- The fixed property will not be treated as a deemed disposal.
- Retirement funds are not subject to CGT.

She indicated on her tax return that she stopped being a tax resident on 28 February 2019. As a result she is deemed to have disposed of all her assets on 27 February 2019, excluding immovable property. It will result in the following CGT (assuming her marginal tax rate for that year is 45%):

Asset subject to CGT	Market value	Base cost	Gain
Fixed property	R3 000 000	R1 900 000	N/A
Share portfolio	R2 400 000	R1 000 000	R1 400 000
Unit trust investment	R1 500 000	R1 000 000	R500 000
Retirement annuity	R1 000 000	N/A	N/A
Total gain			R1 900 000
Less yearly exclusion			R40 000
Net gain			R1 860 000
Inclusion rate of 40%			R744 000
Tax at 45%			R334 800

Johanna will have to pay this additional tax in this tax year due to the change in her tax residency status. As the assets are not actually sold, this can pose a serious cash flow problem as she might have to realise an asset to fund this tax.

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Other factors to consider when moving abroad:

A person's entire financial plan should be revisited to make sure it is still relevant, practical and feasible. It is advised that they also consult with a financial adviser in their new country of residence to ensure that their financial plan makes sense on a worldwide basis.

Some of the factors to consider are the following:

- Determine whether long-term insurance policies will cover the insured person in the new country of residence. Inform the insurer of the relocation and determine if the move will influence the payment of benefits. Also review the beneficiaries to make sure that the proceeds will go where it has to go.
- Review short-term insurance policies covering assets remaining in South Africa. Also consider the impact of the relocation, if any.
- Consider remaining bank accounts and the management of those. For practical purposes it may be necessary to give someone power of attorney or to appoint an alternative signatory.
- Review and reconsider investments. Weigh up the benefits and disadvantages of keeping the investments in South Africa or moving it abroad.
- Revisit the will and determine if it is still executable. It becomes more complex where assets remain in South Africa

and new assets are bought abroad. It is often useful to have separate wills in separate countries. A new financial plan and consultation with a fiduciary specialist will determine what is best.

Avoid surprises

Financial emigration and a change in tax residency should not be considered in isolation. Financial emigration won't necessarily bring a change in tax residency about, and even if clients emigrate in the hope of changing their tax residency, it may not be the case. Plan and consult with industry experts to avoid unpleasant surprises.

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