South African Institute of Tax Professionals

23 November 2020

To: The National Treasury
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The South African Revenue Service
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Via email: National Treasury (2020AnnexCProp@treasury.gov.za)
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RE: ANNEXURE C PROPOSALS: PIT AND EMPLOYMENT TAXES

We attached the comments from the SAIT PIT and Employment Tax Technical Work Group (the WG) in respect Annexure C proposals, as it pertains to personal income tax and employment tax related matters. We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

SAIT PIT and Employment Tax Technical Work Group

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All references to legislation are to the Income Tax Act, No. 58 of 1962 (the ITA) unless otherwise indicated.

1. ADDITIONAL COVID-19 RELATED TAX RELIEF ON FOREIGN INCOME

[Applicable provisions: Section 10(1)(o) and application of Double Taxation Treaties (DTTs)]

1. Introduction

1.1. We appreciate that the expats and visitors locked in within South Africa during this period would benefit from the amendment to section 10(1)(o). However, due to the fact that the amendment was not part of the original tranche of COVID-19 tax relief, an opportunity was not afforded to effectively comment on the amendment, whilst it was in a proposal form. We therefore use this opportunity to provide comment on the amendment, and to request for the expansion in certain areas.

2. Policy intent

2.1. <u>Foreign employment income exemption</u>

2.1.1. The South African tax system is residence-based. In terms of the residence basis of taxation, any person who is considered to be a South African tax resident will be subject to tax on worldwide income and capital gains. According to this basis of taxation, all South African tax residents are taxable in South Africa, irrespective of the source of their income.

2.1.2. The only instances where a tax resident individual would not be taxable on foreign sourced income, is if the South African tax legislation exempts a particular source of income (e.g. section 10(1)(o) of the Income Tax Act, No. 58 of 1962, hereinafter "the ITA"), or alternatively, through the application of a Double Taxation Treaty (DTT), a source of income is taxable in the source country rather than in South Africa.

2.1.3. Section 10(1)(o), basically exempts foreign service income earned by South African tax residents under certain circumstances. 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).*
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> *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".*

2.1.4. 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.

2.1.5. As a result, the structure of section 10(1)(o), has many of the same characteristics as the relevant clauses in DTTs that deals with country's taxation right in respect of foreign employment income.

2.1.6. However, due to concerns regarding abuse, quite a number of provisos and caps have been introduced to prevent categories of employees abusing the foreign service income exemption to earn foreign employment income without foreign taxation.

2.1.7. Internationally, tax relief for tax resident individuals are found in many jurisdictions, and take many forms. These include exemptions, credits and other types of domestic relief. Unfortunately, due to different tax residence determinations in jurisdictions, tax rates and treaty networks it is hard to provide exact comparatives to South Africa. Moreover, in many countries, tax residents may break residence with relative ease, and henceforth be taxed on the source basis, rather on the world-wide basis. In South Africa, tax residence cannot summarily and easily be broken, and as a result, the impact of a foreign employment exemption is much greater than in countries with more porous tax residency requirements.

2.1.8. Specifically of relevance for the current discussion the function of the "days test", that is, the employment is exercised or performed outside South Africa for periods exceeding 183 full days (and in the case of section 10(1)(o)(ii) -) of which more than 60 full days must be continuous, in any 12-month period beginning or ending in a year of assessment.

2.1.9. The days test has two different functions: one is to ensure that the taxpayer qualifies for the exemption and the second test is to quantify the exemption. Once the taxpayer qualifies, the remuneration attributable to the foreign source income is quantified.

2.2. COVID-19 tax relief

2.2.1. As part of the submissions made during the discussion on COVID-19 tax relief, SAIT made proposals to Government regarding the impact of various lockdown regulation on application of section 10(1)(o) to exempt foreign income for South African tax residents.

2.2.2. The reason for the submission was that as a result of the travel bans implemented by various governments worldwide many individuals were literally stuck in South Africa, without being able to return to the country of employment to continue to render services there.

2.2.3. It is recognised that income source through employment in South Africa, should be taxed in South Africa, irrespective of whether the income is earned by a South African tax resident or a foreigner.

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2.2.4. At issue, is that any foreign sourced employment income, earned during the 2021 tax year (1 March 2020 – 28 February 2021) and beyond, would ordinarily have been exempt through the application of section 10(1)(o); however, as a result of the various lockdown regulations, the same foreign sourced employment income would not be exempt due to the inability to meet the 183-day requirement.

2.2.5. In response to the request from the industry, Government included the following amendment in the Taxation Laws, Amendment Bill, 2020:

> *"(c) by the substitution in subsection (1)(o)(ii) for item (aa) of the following item:*
> *''(aa) (a) for a period or periods exceeding 183 full days in aggregate during any period of 12 months; or*
> *(b) for a period or periods exceeding 117 full days in aggregate during any period of 12 months in respect of any year of assessment ending on or after 29 February 2020 but on or before 28 February 2021; and"*

2.2.6. In the presentation to the Standing Committee on Finance (SCoF) by National Treasury and SARS on 13 October 2020, the following was stated:

> *"Comment: Consider reducing the number of days that employees have to be outside South Africa to qualify for the exemption of foreign remuneration.*
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> *– Response: In order to take into account the lockdown period during the COVID-19 pandemic, it is proposed that changes be made in the 2020 draft TLAB so that the 66 days that commence on 27 March 2020 and end on 31 May 2020, when the country operated under Covid-19 alert level 5 and 4, should be subtracted from the 183 day threshold rule used to determine the eligibility for exemption of foreign remuneration.*
>
> *– In order to qualify for exemption, the number of days that a person spent working outside South Africa will be reduced to more than 117 days in any 12 month period, for years of assessment ending from 29 February 2020 to 28 February 2021.*
>
> *– The current requirement in section 10(1)(o)(ii) that 60 of the days abroad should be a continuous period remains as is. In view of the fact that these individuals would have qualified for section 10(1)(o)(ii) exemption if there was no lockdown due to COVID 19 pandemic, the proposed relief to reduce the number of days from 183 to 117 in order to take into account the lockdown period during the COVID-19 pandemic is likely to be revenue neutral and will have minimal impact on the fiscal framework."*

3. The legal nature of the problem

3.1. Rationale behind the relief granted through the exemption not fully applied

3.1.1. The rational as we understand it, seems to be that South African tax residents that would have been eligible for the application of section 10(1)(o), should not be prejudiced by virtue of the effect of COVID-19, to the extent that they were not able to exit South Africa to take up employment abroad.

3.1.2. The premise that National Treasury appears to be basing the calculation in its amendment on, is that South African tax residents were prevented from exiting South Africa and taking up employment abroad during COVID-19 alert level 5 and 4.

3.1.3. However, there are a number of factors that in practice can either prevent an individual from continuing employment in the foreign country (and therefore cause them to be repatriated to South Africa), or alternatively taking up employment in the foreign country (e.g. not being allowed to enter the foreign country of employment.

3.1.4. The SA national lock down (with effect from 26 March 2020 midnight) has been complicated, and continues to be so, by the travel bans that were implemented world-wide, (even prior to SA lockdown date). These foreign country lock-downs or travel bans resulted in many individuals being unable to leave or enter South Africa to perform their duties in the country of residence, in the country where they were assigned / seconded to, or in the country where their employer may be incorporated.

3.1.5. As a result, many non-resident travelers intending to leave the country were trapped in South Africa. Furthermore, a number of South African tax residents, who would otherwise have qualified for the exemption from South African tax on foreign sourced remuneration in terms of section 10(1)(o)(ii) would fail to do so as they –

- Would not have remained outside South Africa for the 183 full days;
- Would not being able to return to the country where they are exercising their employment; and
- Could only make the 183 full day requirement in a 12-month period that does not include a 60 full continuous day period.

3.1.6. The travel restrictions and lockdown periods in South Africa were not limited to the SA national state of emergency, but are also applicable in other countries and their travel restrictions, e.g. Italy, and Mexico announced travel restrictions during January 2020, and implemented certain measures soon after new year. From the first two weeks of 2020 several European, Mexican and Chinese employers requested South Africans not to return from their annual Christmas holidays.

3.1.7. It appears that if the rationale is that South African tax residents, that would have been eligible for the application of section 10(1)(o), should not be prejudiced by their COVID-19 related restriction of movement, then the relaxation should take into account a broader understanding of the restrictions. It is unlikely that COVID-19 will follow a linear progression; rather, it may flare up from time to time, and as a result sporadically cause severe restriction of movement in the future.

3.2. <u>The amendment does not cover substantially similar circumstances</u>

3.2.1. Sections 10(1)(o)(i) and 10(1)(o)(iA) has substantially the same application principles, as section 10(1)(ii) in that it provides for a tax exemption of the earned employment income that accrues, or is paid to an officer or crew member of a ship, engaged in the international transportation of goods and passengers, if they are outside South Africa for 183 days during a year of assessment.

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3.2.2. As a result of the seasonal nature of cruises, it appears that some of the officers and crew that have been eligible to claim exemptions in terms of section 10(1)(o)(i) or 10(1)(o)(iA) in prior years are not able to do so for the 2020 tax year. It seems warranted to allow these individuals the same level of relief as their counter-parts relying on section 10(1)(o)(ii).

3.3. International precedent and DTTs

3.3.1. The OECD has issued Policy Responses to the Coronavirus (COVID-19). We refer specifically the OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis, which was issued on 3 April 2020. Under the heading: "*4. Concerns related to cross border workers*":

"21. Where a government has stepped in to subsidise the keeping of an employee on a company's payroll during the COVID-19 crisis, the income that the employee receives from the employer should be attributable, based on the OECD Commentary on Article 15, to the place where the employment used to be exercised. In the case of employees that work in one state but commute there from another state where they are resident (cross border worker), this would be the state they used to work in.

Explanation

22. Article 15 (Income from employment) of the OECD Model governs the taxation of employment income, distributing the right to tax between the employee's state of residence and the place where they perform their employment.

23. The starting point for the rule in Article 15 is that "salaries, wages and other similar remuneration" are taxable only in the person's state of residence unless the "employment is exercised" in the other state. The Commentary on Article 15 explains that this means the place where the employee is "physically present when performing the activities for which the employment income is paid." But there are conditions attached to the place of exercise test. That other state (the source state) may exercise a taxing right only if the employee is there for more than 183 days or the employer is a resident of the source state, or the employer has in the source state a permanent establishment that bears the remuneration.

24. Some stimulus packages adopted or proposed by governments (e.g. wage subsidies to employers) are designed to keep workers on the payroll during the COVID-19 crisis despite restrictions to the exercise of their employment. The payments that employees are receiving in these circumstances most closely resemble termination payments. These are discussed in paragraph 2.6 of the Commentary on Article 15 of the OECD Model, which explains that they should be attributable to the place where the employee would otherwise have worked. In most circumstances, this will be the place the person used to work before the COVID-19 crisis.

25. Where the source country has a taxing right, the residence country must relieve double taxation under Article 23 of the OECD Model, either by exempting the income or by taxing it and giving a credit for the source country tax.

26. A change of place where cross-border workers exercise their employment may also affect the application of the special provisions in some bilateral treaties that deal with the situation of cross-border workers. These provisions apply special treatment to the employment income of cross-border workers and may often contain limits on the number of days that a worker may work outside the jurisdiction he or she regularly works before triggering a change in his or her status.

27. *More widely, if the country where employment was formerly exercised should lose its taxing right following the application of Article 15, additional compliance difficulties would arise for employers and employees. Employers may have withholding obligations, which are no longer underpinned by a substantive taxing right. These would therefore have to be suspended or a way found to refund the tax to the employee. The employee would also have a new or enhanced liability in their state of residence, which would entail returning that income. Exceptional circumstances call for an exceptional level of coordination between countries to mitigate the compliance and administrative costs for employees and employers associated with involuntary and temporary change of the place where employment is performed. The OECD is working with countries to mitigate the unplanned tax implications and potential new burdens arising due to effects of the COVID-19 crisis."*

3.3.2. In order to provide certainty, it seems prudent that guidance in the form of a statement of intent (or "explanation") be published so that taxpayers will be able to determine their tax liability during these uncertain times.

4. A detailed factual description

4.1.1. The WG are willing and able to provide examples of any of the scenarios described above. Refer also to the examples discussed hereunder.

5. The nature of the business / persons impacted.

5.1.1. South Africa tax residents and expatriates.

6. Proposals

6.1.1. If one could summarise the COVID-19 pandemic and the effect that it has had (and continue to have) on many areas of our lives, it could be "unpredictable". In our view, if a situation is volatile and in flux, it may be prudent to create a mechanism to apply objectively to subjective facts in some instances, rather than a hard and fast rule in all instances. However, having to review subjective facts is costly, so from an administrative cost perspective, at least a partial set rule may be required. We frame our proposals hereunder with these principles in mind.

6.2. <u>Specific structural proposals -</u>

6.2.1. We understand the +60-day test being retained. However, we propose that the "any twelve-month period" requirement be extended by the same number of days.

6.2.2. Specifically, South African employers seconding South African employees to other countries reduced the period of stay, mainly for costs reasons. Rotating teams were to typically undertake their +60 days period in either the period between Christmas and Easter Holidays or subsequent to Easter. For many, not because of choice, but because of their employers cost cutting measures their +60-day trips were as far apart as legally allowable.

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6.2.3. For other employers, because of the maximum 183 day exempt temporary accommodation provisions, the seconded rotational teams were not allowed to stay in country between rotations, they had to return to South Africa. Where foreign construction sites have limited accommodation, the seconded team's stay was severely restricted to ensure the replacement teams had adequate accommodation and employees were only allowed one +60-stay in 16-month period.

6.2.4. It is therefore proposed that the 66-day period be included as a minimum (without proof being required), but that upon satisfactory proof being provided to SARS of governmental travel restrictions preventing travel from South Africa to another country, the entire travel restriction period, as commencing on the day the other country announced restrictions if having commenced prior to 27 March 2020 or ending after 31 May 2020, as the case may be, must be considered as an addition to the "any twelve-month cycle".

6.2.5. We accept the law can probably only deal with cases on an 80:20 principle but it should be noted that there are a few expats that is now overstaying the 183 limited days in temporary hotel accommodation since relocation date. Not only is their foreign employment income exemption now capped to R1,25m, but they are now also facing an increased taxable income in addition to being forced to stay in hotel accommodation as their new homes are either not complete or their families cannot join them in the other country.

6.3. International precedent and DTTs

6.3.1. We also recommend the number of days test in treaties (DTA's) and other parts of the act be increased by at least the same minimum 66 number of days or such longer period as may be proven to the Commissioner for SARS. In terms of Article 14 or 15 (of most South African treaties) (and as included in Article 15 of the OECD Model Tax Convention), the 183 days in any period of 12 months, or fiscal year (as the case may be) should not be applied in the 2020, 2021 and probably 2022 tax years.

6.4. The amendment does not cover substantially similar circumstance

6.4.1. We recommend that the reduced days count be made applicable to all the provisions in section 10(1)(o).

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2. WITHDRAWING RETIREMENT FUNDS UPON EMIGRATION

[Applicable provisions: Section 1 of the Act, the definitions of "Pension Preservation Fund", "Provident Preservation Fund" and "Retirement Annuity Fund"]

2.1. Background

2.1.1. Numerous submissions were made regarding the proposed amendment; however, in the *Draft Response Document on the 2020 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2020 Draft Taxation Laws Amendment Bill and 2020 Draft Tax Administration Laws Amendment Bill* (13 October 2020), SARS and National Treasury indicated that they would not be amending the three-year rule, substantiating this decision with the following response:

> *"The 3-year rule is a mechanism to ensure that there is a sufficient lapse of time for all emigration processes to have been completed with certainty, without affecting such workers whose residence status changes for reasons other than emigration. The current system of financial emigration imposes a lot of strictures, not least its requirement that individuals close bank accounts and credit cards and repatriate funds that are taken out above the limits if return to the country before 5 years has elapsed. The envisaged system as a whole will have much lower compliance burdens overall for those looking to move abroad, and therefore it is not useful to focus on the 3-year requirement in isolation of the overall policy change.*
>
> *One of the main objectives of the reform is to modernise the capital flow oversight system in a manner that balances the benefits and risks of more mobile people, financial flows and cross-border transactions. Now there is recognition that people's working lives may well include a unique combination of periods spent in South Africa and abroad. One possibility is emigration, with a multitude of possibilities on the continuum between emigration and a short business trip abroad. Policy design has to take all of these options into account, while the most vocal comments have focussed on only emigration.*
>
> *When individuals contribute to pensions (tax-free), the understanding is that tax is deferred until benefits are received upon retirement. Government did not intend to provide a tax incentive for funds to be used for emigration. Our attempt is to reconcile the choice to emigrate and electing to withdraw a retirement lump sum with the design principle of deferred taxation upon retirement. This also illustrates a horizontal equity point: tax residents who decide not to emigrate have to wait until retirement for withdrawals from retirement annuity funds."*

2.2. Discussion of the draft response and recommendation

2.2.1. We have several concerns around the proposed amendment which we have summarised below. These concerns should be seen in addition to the comments made in our original submission, which also included several examples of scenarios where we foresee problems with the draft amendments. Our concerns are grouped under the various headings below.

2.2.2. <u>Over-complication</u>

2.2.2.1. We are concerned that the proposed amendment is creating unnecessary complexity through the three-year requirement, in instances where a retirement fund member ceases to be a tax resident and seeks to withdraw their retirements savings. This is further explained in some of the other points below.

2.2.3. Original intention of the affected subparagraphs

2.2.3.1. The amendments over the years, have reflected an intention which is not aligned to the current amendment.

2.2.3.2. Taxation Laws Amendment Bill (TLAB), 2008

2.2.3.2.1. Paragraph (b)(x)(dd) of the proviso to the definition of "retirement annuity fund" was first inserted by section 2(1)(zB) of the Taxation Laws Amendment Act No. 3 of 2008. The explanation for the amendment was provided in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 2008 as follows:

> *"Current Law*
>
> *Members of a retirement annuity fund may not withdraw their funds prior to retirement except where the value is very small.*
>
> *Problem Statement*
>
> *Where members of a retirement annuity fund emigrate before retirement, those members are unable to withdraw their funds until such time as they retire (which may be many years into the future).*
>
> *Proposal*
>
> *It is proposed that the Act be amended to allow members who emigrate from South Africa before they retire to withdraw their funds prior to retirement, provided they pay the full tax on the benefit."*

2.2.3.2.2. It is clear from the Explanatory Memorandum that the intention behind the original amendment was to enable members of a retirement annuity fund to access their savings when they ceased to be a resident. The reference to the South African Reserve Bank was merely included as a means of providing a test to confirm the change of residence and this is discussed in further detail below.

2.2.3.3. TLAB 2015

2.2.3.3.1. In 2015, this part of the definition of "retirement annuity fund" was amended to allow individuals to withdraw a lump sum from the retirement annuity fund –

- when the individual ceases to be tax resident; or
- when the individual leaves South Africa at the expiry of the work visa contemplated in the Immigration Act No. 13, of 2002.

2.2.3.3.2. The reasons for this amendment was stated in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 2015 as follows:

> *"The current provisions do not allow for expatriates to withdraw a lump sum from their retirement annuity when they cease to be tax resident and leave South Africa or when they leave South Africa at the expiry of the work visa. The definition of "retirement annuity fund" in section 1(b)(x)(dd) provides for a lump sum payment of benefits where the member emigrated from the country and that emigration is recognized by the South African Reserve Bank for the purposes of exchange control.*

This definition only caters for South African nationals who emigrate to another country. When expatriates cease to be tax resident and/or leave South Africa after the term of the fixed employment contract, or when they leave South Africa at the expiry of their work visa, they are not regarded as having emigrated by the South African Reserve Bank for the purposes of exchange control. As a result, they are not entitled to receive a lump sum payment from their retirement annuity funds."

2.2.3.4. TLAB 2016

2.2.3.4.1. This amendment therefore sought to broaden the scope of the concession granted by this paragraph. The reference to the emigration as recognised by the Reserve Bank was removed in 2015 but was reinserted in 2016 due to concerns that a loophole had been created. The following was stated in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 2016:

"It has come to Government attention that exclusion of the requirement that an individual must emigrate from the Republic and that emigration must be recognised by the South African Reserve Bank for purposes of exchange control creates a loophole for South African nationals or tax residents to be able to make an early withdrawal from their retirement annuity funds, without formally emigrating. This was not the original policy intention."

2.2.3.4.2. The second option, which permits members of retirement annuity funds to access their savings when they leave South Africa at the end of their work visa, has remained in the definition and remains unaffected by the three-year clause that is in the 2020 proposed amendment.

2.2.3.4.3. The definitions of "pension preservation fund" and "provident preservation fund" were inserted into the Act by sections 2(1)(v) and (w) of the Taxation Laws Amendment Act No. 3 of 2008 (TLAA, 2008). The Explanatory memorandum to the TLAA, 2008, explained the nature and role of these preservation funds as follows:

"The proposed new definitions effectively untie a preservation fund from the employer-employee relationship that is a requirement for the approval of an occupational pension or provident fund. The proposed definitions will allow an employee to choose his or her own pension or provident preservation fund upon termination of employment. Transfers between the preservation funds of the same type will also be possible and no person will be 'trapped' in any preservation fund.

In addition, the definition allows for membership and transfer of benefits of divorcees, who previously had a limited choice of retirement vehicles in which to house their divorce settlements payable from pension or provident funds of former spouses.

In terms of the proposal, preservation funds can also be established to house 'unclaimed benefits' (e.g. where no benefit has been paid to a member or his dependants within 24 months of the benefit becoming due).

Transfers to preservation funds will be tax-free (paragraph 6 of the Second Schedule) and growth within these funds will also be tax-free (section 10(1)(d)(i) of the Income Tax Act). Payments from these funds will be subject to tax calculated on the same basis as similar payments from pension, provident and retirement annuity funds."

2.2.3.5. 2018 TLAB impact on Preservation funds

2.2.3.5.1. Prior to 2018, emigration was not a criterion for preservation fund members to access savings. This changed in 2018 with the introduction of paragraph (c)(ii) of the proviso to the definition of "pension preservation fund" and paragraph (c)(ii) of the proviso to the definition of "provident preservation fund" by sections 1(1)(n) and (t) of the Taxation Laws Amendment Act No. 23 of 2018, with effect from 1 March 2019. The reason for the change and the proposed amendment was described in the Explanatory Memorandum to the Taxation Laws Amendment Bill, 2018 as follows:

> ***"Reasons for change***
>
> *The current provisions of the Act only allow members of retirement annuity funds to be able to access and withdraw the full value of their post-tax retirement benefits upon emigration or repatriation on expiry of the work visa, while members belonging to pension preservation funds or provident preservation funds are restricted from doing so.*
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> *As a result, when members of pension preservation or provident preservation funds emigrate from South Africa and such emigration is recognised by the South African Reserve Bank for the purposes of exchange control or upon repatriation on expiry of their work visas, they are not entitled to receive a lump sum payment from their pension preservation or provident preservation funds.*
>
> ***Proposal***
>
> *In order to promote Government's policy of a uniform approach on the tax treatment of all retirement funds, it is proposed that the tax treatment of different types of preservation fund withdrawals be aligned to allow members of all preservation funds to be able to access and 10 withdraw the full value of their post-tax retirement benefits upon emigration or repatriation on expiry of the work visas.*
>
> *Consequently, it is proposed that the definitions of "pension preservation fund" and "provident preservation fund" in section 1 of the Act be amended to make provision for the members of pension preservation funds and provident preservation funds to be entitled to withdraw their full lump sum benefit when they emigrate from South Africa and such emigration is recognised by the South African Reserve Bank for the purposes of exchange control or upon repatriation on expiry of their work visas."*

2.2.3.5.2. The original motivation for the 2018 amendment to the definitions of "pension preservation fund" and "provident preservation fund" was therefore based on horizontal equity: to ensure that all members of retirement funds had similar access to their funds, which was in line with the long-term retirement fund reform project that sought to align the three types of retirement funds.

2.2.3.5.3. The reference to the approval of the South African Reserve Bank was included as a means of providing a test to confirm the change of residence. This did however place undue reliance on the test of "financial emigration" which, as was alluded to in the 2020 Budget Speech, and as is widely confirmed by tax and exchange control experts, has been inappropriately used and misconstrued. We agree that the reliance on the South African Reserve Bank should be removed, especially in line with the proposal, as stated in the 2020 Budget Speech, to move away from this concept of emigration and the existing exchange control regime. However, we do not find any plausible justification to introduce an additional restriction in the form of the three-year deferral that is included in the proposed 2020 amendments.

2.2.3.6. A new and unique approach contrary to the original intention

2.2.3.6.1. If the test to be used for determining whether a member can access their retirement benefit is the status of whether the person is a "resident", the well-established tests that determine a person's residence status should be sufficient for this purpose. Introducing an additional test in the form of the three-year deferral rule, in our view, unnecessarily obfuscates the matter.

2.2.3.6.2. In order to determine whether, in fact, a person has truly ceased to be a resident does not align with the approach taken in the definition of a "resident" in section 1(1) of the ITA, read together with SARS Interpretation Notes numbers 3 and 4.

2.2.3.6.3. Interpretation Note No. 3 (Issue 2), states in paragraph 4.3:

> *A natural person who ceases to be ordinarily resident in the Republic will not be "resident" in South Africa from the day that person ceased to be ordinarily resident in the Republic... 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.*
>
> *Thus, the determination of the change in residence happens at the point of ceasing to be a resident, not at a later date with a backward view as is now required under the proposed amendment for the purpose of accessing retirement savings.*

2.2.3.6.4. Interpretation Note No. 4 (Issue 5), states in paragraph 4.4:

> *A natural person, who is resident by virtue of the physical presence test, ceases to be a resident when that person is physically outside the Republic for a continuous period of at least 330 full days. Residence will cease from the day that the person left the Republic.*

2.2.3.6.5. Although there is a requirement for a continuous period of absence of at least 330 full days, once this requirement has been met, the change in residence occurs. There is no requirement to wait for a period as is now being considered in the amendments regarding access to retirement savings. Thus, we do not agree with the argument that there needs to be "a sufficient lapse of time [to allow] for all emigration processes to have been completed with certainty" as this does not exist in any other part of the legislation.

2.3. Concerns about the tax incentive

2.3.1. We accept that there is tax incentive in allowing deductions for contributions into the fund and there is a small concession in that the first R25 000 of withdrawal benefits are free of tax (noting that this is a lifetime limit). Nonetheless, the balance of any withdrawal benefit is fully taxed, the withdrawal of retirement savings upon ceasing to be a resident does not result in a loss to the fiscus as there will be a tax liability on these withdrawals.

2.3.2. <u>Focusing on the group most affected: members of retirement annuity funds</u>

2.3.2.1. The amendment affects individuals who have saved into retirement funds. Although members of pension preservation and provident preservation funds are affected, their impact will not be as severe in practice, as they are permitted one withdrawal from the fund under the normal preservation fund rules and they will, therefore, be able to access their retirement savings upon emigration, albeit under a different rule.

2.3.2.2. Members of retirement annuity funds do not have this facility, as they may not access any of their funds until the reach at least 55 years of age, and they will therefore be the group that will be most affected by the amendment.

2.3.2.3. Members of pension and provident funds are those in formal employment, whether in the public or private sector, where the employers have established pension and provident funds. Members of retirement annuity funds are typically individuals who are self-employed, or employed by smaller companies in the informal sector, where these employers do not have the means and processes necessary to set up pension and provident funds. We are concerned that these individuals will be the ones most affected by the proposed amendment and we see no reason why they should be unfairly targeted.

2.3.3. Undue complexity for minimal impact

2.3.3.1. It is also our concern that the real impact of this proposed amendment is negligible, yet it introduces a significant layer of complexity into the legislation. In seeking to establish data on the level and type of wealth in South Africa, Orthofer (2016) found that less than five percent of adults in South Africa reported owning a retirement annuity.

2.3.3.2. The relative impact of the proposed amendment can also be illustrated in the magnitude of retirement annuity savings as reported in SARS Statistics (2017),[1] which indicated retirement annuity fund deductions of R19,6 billion, comprising only 1% of the total assessed taxable income of R1 441 billion for that year (this may be compared to pension contributions which amounted to R36,1 billion in the same year).

2.3.4. Disincentivising responsible financial planning

2.3.4.1. We are concerned that the proposed amendment will impact future decision-making regarding retirement savings and the management of funds when changing employment.

2.3.4.2. Current and future members of retirement funds will be hesitant to transfer funds to preservation funds and to invest in retirement annuity funds if they foresee that there may be additional restrictions on their freedom of choice regarding their savings in the future. Research indicates that retirement savings are perilously low in South Africa (see, for example Swart (2012); Snyman, van der Berg-Cloete and White (2017) and there are many other readily available references). As the maintenance of our retirement funds is critical in the preservation and growth of private savings in South Africa, we believe that every effort should be made to promote confidence in retirements savings for existing and future income earners. This amendment will very likely have a negative impact on retirements savings.

2.3.5. Administrative and practical concerns

2.3.5.1. In our original submission we described several scenarios where we anticipate administrative and practical complications in applying this amendment; i.e., what documentation will a taxpayer have to provide to demonstrate that they have remained a non-resident for three years.

[1] This year was selected as the statistics still reflect the separate deduction for retirement annuity contributions under section 11(n), which has since been replaced by section 11F.

2.4. Conclusion

2.4.1. Whilst we appreciate that an amendment must be put in place to function as a test, we request that consideration be given to withdrawing the 3-year requirement, or alternatively replacing it with a more reasonable period.

<u>End</u>.

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