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TAXTALK
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GUIDE TO GLOBAL MOBILITY

[Expats, Inpats & Offshore Savings]

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Tell us what you think. Questions and suggestions can be sent to editor@thesait.org.za

FINDUS

Postal address
PO Box 712
Menlyn Retail Park
0063

Editorial head office
Riverwalk Office Park, Building A
C/o Garsfontein & Matroosberg Roads
Pretoria
South Africa
0081

Advertising sales consultant
4Evers Marketing Solutions
Collette Evers
collette@4evers.co.za
Cell: 082 349 9914

THETEAM

Editor at Large
Tania Wolson
editor@thesait.org.za

Supporting Editor
Jeanne Viljoen
taxtalk@thesait.org.za

Editorial Advisors
Keith Engel
Beatrie Gouws

Design and Layout
Nastassja Hewitt
designer@thesait.org.za

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Metamorworks

Proudly Brought
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sait South African Institute of Tax Professionals

GUEST CONTRIBUTORS

Tarryn Atkinson
tarryn.atkinson@firstrand.co.za / 084 725 6635

Tarryn is Head: Employees' Tax and Benefits at FirstRand Bank Limited. She specialises in employees' tax and the Tax Administration Act. She is an attorney and chartered accountant.

Lesley Bosman
Lesley.bosman@kpmg.co.za / 082 719 5523

Lesley is Associate Director at KPMG Services (Pty) Ltd where she specialises in corporate tax. She holds a BCom, LLB and HDip Tax.

Barbara Curson
batier@icon.co.za / 064 451 3088

Barbara is a freelancer and columnist who specialises in tax avoidance and financial reporting. She is a CA(SA) and holds a BCom (Economics and International Economics), a Hons BAcc Science, HDip Tax and HDip International Tax.

Elizabete da Silva
Elizabete.dasilva@za.ey.com / 083 601 1337

Elizabete is the Executive Director People Advisory Services at Ernst & Young Advisory Services (Pty) Ltd. She holds an HDip International Tax.

Jean du Toit
jean@taxconsulting.co.za; 079 523 4252

Jean is Head of Tax Technical at Tax Consulting South Africa. He holds an LLB and LLM (Tax).

sait MTP(SA) member

Doné Howell

dhowell@bdo.co.za / 071 211 0727

Doné is Director at BDO Tax Services (Pty) Ltd. She specialises in the area of personal income tax and holds a BCom Accounting and Postgraduate Diploma in Tax.

Harry Joffe

harryj@discovery.co.za / 011 529 5603

Harry is Head of Legal Services at Discovery Life. He specialises in estate planning; personal, investment and insurance tax; and estate duty. He holds the following qualifications: BA LLB, HDip Tax, LLM (tax), CFP, Advanced Diploma in Corporate Law, and TEP.

Mark Korten

mark@kortenconsulting.com / 082 781 7085

Mark is the Managing Director of Korten Consulting Ltd. He specialises in all areas of South African tax from an international perspective, international estate planning, emigration and foreign residency planning, Mauritian taxation and international tax rules associated with the use of offshore jurisdictions and cross border activities. He holds a BCom, LLB, and HDip Tax.

Johnnie Kruger

johnnie@taxconsulting.co.za / 072 483 3309

Johnnie is a Tax Attorney – International Tax at Tax Consulting South Africa. He is an admitted attorney and holds an LLB.

Jonty Leon

jonty@taxconsulting.co.za / 076 512 9108

Jonty is an Expatriate Tax Attorney at Tax Consulting South Africa. He is an admitted attorney and holds an LLB.

GUEST CONTRIBUTORS

Cecelia Madden
cecelia.madden@kpmg.co.za / 082 719 5658

Cecelia is Associate Director, Global Mobility Services & Employment Tax Advisory at KPMG Services (Proprietary) Limited. She specialises in managing large expatriate engagements, including providing international tax planning advice, double taxation agreement interpretation, advising on the taxation of employee incentive compensation schemes, and expatriate policy development.

Lesego Matsheka
lesego.matsheka@kpmg.co.za / 082 719 5671

Lesego is Senior Immigration Manager at KPMG Services (Pty) Ltd. His area of tax specialisation is immigration.

Reabetswe Moloi
rea@taxconsulting.co.za / 079 613 6942

Reabetswe is Tax Specialist at Tax Consulting South Africa. She is an Admitted Attorney and holds an LLB.

Duane Newman
dnewman@cova-advisory.co.za / 082 783 5057

Duane is the Director at Cova Advisory. He is also a SAIT Board Member, and Chair of SAIT's Finance Board Committee, Tax Incentives Working Group and Carbon Tax Working Group. He specialises in customs and excise, carbon tax, and Government incentives. He holds a BAcc.

Craig Turton
cturton@purplegroup.co.za / 087 940 6000

Craig is Vice President Wealth at Easy Equities. His areas of specialisation are investments and personal tax. He holds a PGDip in Financial Planning.

Zaahid is Senior Tax Manager, Global Mobility Services & Employment Tax Advisory at KPMG Services (Proprietary) Limited. He specialises in both tax compliance and consulting for foreign nationals of large corporate clients on national and international taxation and employees' tax issues. He holds a BCom, HDip in Tax Law and a Certificate in Advanced Tax Practice

Karen is a Content Developer and Facilitator at The Tax Faculty. She specialises in areas of corporate tax, VAT, payroll tax, trusts and estates. She holds a BCom (Honours) Accounting and a Certificate in the Theory of Accounting.

Hugo is a Cross-border Specialist at Taxforum where he specialises in areas of cross-border and exchange control. He holds an MCom (Tax) and is a CA(SA).

Louis is the Managing Director at Wealth Succession Pty Ltd. He specialises in the following areas: estate duty, capital gains tax, transfer duty, local trust taxation, offshore trust taxation, and donations tax. He holds an LLB.

Tarissa is an Immigration Specialist and Head of Africa Desk at Xpatweb. She is passionate about providing immigration solutions across the African continent.

EXPATRIATE BENEFITS AND THEIR TAX IMPLICATIONS

30 minutes CPD

▸ **ELIZABETE DA SILVA,** elizabete.dasilva@za.ey.com

Our article looks at the tax impact on employees and employers where the employer pays for some or all of the unique lifestyle costs associated with an employee working in a foreign location, especially in hardship areas that lack basic essentials.

As global organisations share in resource pools available to the group, and expatriates with scarce skills move from one country to another as the need arises, expatriates may spend most of their working life away from the country they call home.

In any strategic move it is important to allocate the most suitable candidate to ensure the success of the project, which may lead to expats having the upper hand in reward negotiations. Ultimately this creates a misconception that expatriates are generously remunerated and flooded with benefits that merely enrich them, or as a privilege received, without incurring any or limited tax consequences. In order to ensure effective global mobility management, it is critical that global mobility policies are introduced and aligned to the business and talent needs. These policies may differ depending on the type of assignment and typically the length of the assignment.

Assignment policies

The following are common policies used by global organisations:

- Long-term strategic mobility policies: periods of assignment between 3 and 5 years
- Short term assignment policies: periods of assignment of up to 6 months
- Developmental assignment policies

Based on the type of policy implemented by the organisation, the compensation may differ. Typically the more strategic policies will have a greater economic benefit as the assignment is aimed at professionals with scarce skills. The return on investment may not even be considered if the assignment is strategically important to the group as a whole.

Mobility policies are also designed with specifics related to the country of assignment, and the compensation components will be aligned to the specific assignee needs in that particular country.

Assignment specific allowances or benefits will differ per industry and per country, often dependent on the working conditions and the compliance laws of the country of assignment. As an illustration, in the mining or oil and gas industries, expatriates will be based in areas where living conditions are harsh and often cannot accommodate their families. Companies will build a support base around the site where workers are based, making conditions for all workers comfortable and safe.

Some expatriates are expected to work long hours for limited periods of time and then have a period of time off to visit their family. The expatriate may as a consequence have received a benefit in the form of a service rendered, at the expense of the employer, where the service has been used for private use, for no consideration. A taxable benefit will arise, without considering the true nature of the assignment and the fact that the benefit may be regarded as a necessary part of the project cost – easing the harsh conditions expatriates endure and ultimately securing the success of the assignment. If assignees are not allowed to visit their families at home during their time off, they may not even consider accepting the assignment. Therefore, the benefit should rather be regarded as an integral part of the project costs and not necessarily a personal benefit or a privilege the assignee enjoys.

“The expatriate is often provided with access to a professional service provider who will prepare and address the compliance requirements in the country where the assignee is based.”

The logistic conditions specific to a particular country may also determine the type of benefit included in an assignment policy. The benefit may be provided to protect the employer who ultimately may inherit risks associated with sending an employee to a country with poor infrastructure and political instability.

There are numerous other benefits which are considered essential to certain types of assignment. However, their tax impact, both in South Africa and in the country of assignment, are important to note.

Tax impact on South African tax residents

Changes were made to the foreign income legislation, effective 1 March 2020. To fully understand the extent of the impact on employers and assignees, a comparison of the taxable rules applicable in South Africa and the country of assignment (in this case Nigeria) has been analysed below. The list is in no way a full representation of all expatriate benefits.

South African tax residents will now pay tax on benefits specific to an assignment in another country, where the rules of the assignment country may not regard those benefits as taxable benefits. An assignee on a R2 million taxable assignment package in Nigeria, which excludes the benefits regarded as non-taxable (as illustrated above), may have an equivalent taxable income, based on the South African Income Tax Act, of over R3 million. Even if the exempt amount of R1.25 million and a foreign tax credit is applied, the majority of the above benefits will be fully taxable as they will not be reduced by a foreign tax credit. In the event that the assignee is tax equalised, the employer now has to bear the additional cost of the tax on these differences. The tax covered by the employer will further be regarded as a taxable benefit and will have to be grossed-up. Ultimately the tax rate applied may be as high as 80% of the total package value.

The R1.25 million exemption is in no way enough to cover all the additional benefits which are taxable. Yet they may not be regarded as a personal privilege by expatriates but rather a necessity in countries of hardship.

TAXABLE RULES IN SOUTH AFRICA AND NIGERIA

<table>
<tr><th>TYPE OF BENEFIT</th><th>TAXABLE IMPLICATION IN SOUTH AFRICA AS PER INCOME TAX ACT</th><th>TAXABLE IMPLICATION IN NIGERIA AS PER PERSONAL INCOME TAX ACT</th></tr>
<tr><td>KIDNAP AND RANSOM RISK</td><td rowspan="8">The cash equivalent of the value of a taxable benefit deemed to have been granted by an employer is the amount of expenditure incurred by the employer in respect of any premium payable under a policy of insurance, either directly or indirectly for the benefit of the employee, his or her child, dependant or nominee.

Where an appropriate portion of the expenditure cannot be attributed to the employee, for whose benefit the premium is paid, the value of the taxable benefit is the total of the value paid by the employer for all the expatriates, divided by the number of expatriates.</td><td rowspan="8">Risk insurance benefits paid by an employer to a risk fund for the benefit of its employees is not regarded as a taxable benefit.</td></tr>
<tr><td>EMERGENCY EVACUATION</td></tr>
<tr><td>INTERNATIONAL MEDICAL COVERAGE</td></tr>
<tr><td>PERSONAL ACCIDENT INSURANCE.</td></tr>
<tr><td>DISABILITY INCOME PLANS</td></tr>
<tr><td>GLOBAL LIFE INSURANCE</td></tr>
<tr><td>TRAVEL INSURANCE PLANS</td></tr>
<tr><td>GROUP AND INDIVIDUAL PLANS</td></tr>
<tr><td>LANGUAGE LESSONS</td><td rowspan="3">Longer term assignments include benefits which are directly linked to the successful establishment of the assignee and his family in an assignment country. These benefits are regarded as a free or cheap service provided by an employer for no consideration and the taxable value is dependent on the cost to the employer.

There are, however, certain exclusions, which relate directly to the expatriate relocation and are seen as a direct link to the project and not as a privilege to the expatriate personally.</td><td rowspan="3">Non-taxable.</td></tr>
<tr><td>CULTURAL LESSONS</td></tr>
<tr><td>TRANSPORT OF PERSONAL BELONGINGS TO NEW LOCATION</td></tr>
<tr><td>SCHOOLING BENEFITS</td><td>Taxable benefit which is taxable in the hands of the employee. The value of the taxable benefit is the cost to the employer.</td><td>Taxable benefit which is taxable in the hands of the employee.</td></tr>
<tr><td>COMPANY CAR</td><td>3.5% (or 3.25% if the cost of the car includes a maintenance plan) of the cost of the car inclusive of VAT is applied as a fringe benefit and taxed.</td><td>5% of the cost of the car is included as a taxable benefit.</td></tr>
<tr><td>DRIVER</td><td>Regarded as a free or cheap service and taxed as a fringe benefit. The salary paid to the driver is regarded as the taxable value of the benefit.</td><td>Taxable benefit which is taxable in the hands of the employee.</td></tr>
<tr><td>HOME LEAVE FLIGHTS</td><td>Flights are not taxable as long as the flight cost relates to the relocation of the assignee in Nigeria. Home leave flights will be regarded as a taxable benefit.</td><td>Flights are not taxable as long as the flight cost relates to the relocation of the assignee in Nigeria. Home leave flights will be regarded as a taxable benefit.</td></tr>
<tr><td>PROFESSIONAL TAX SERVICES</td><td>Taxable benefit, based on the fee paid to the professional service provider.</td><td>Non-taxable.</td></tr>
</table>

Tax administration support

In many expatriate policies, the alignment to country-specific compliance requirements is incorporated. The expatriate is often provided with access to a professional service provider who will prepare and address the compliance requirements in the country where the assignee is based. In certain cases the assignee's home country compliance service is also offered as a combined benefit.

This professional service benefit has been largely debated among tax professionals and global employers, as the benefit was not regarded by the industry as a personal benefit or privilege enjoyed by the assignee.

In a recent High Court case, *BMW SA v CSARS*, it was ruled that the benefit is a taxable benefit in the hands of the expatriate. The value of the taxable benefit is based on the cost to the employer of the services provided.

The employer is required to establish the element of the tax services that specifically relates to the expatriate. Elements of the service may, however, relate to the correct determination of the tax liability. This information will be processed by the employer in a payroll, and therefore is not for the personal benefit of the expatriate. In the event that the expatriate is on a tax equalisation policy, the service is mainly provided to mitigate the risk of non-compliance associated with the employer's reporting requirements.

Many expatriates and their employers are now faced with crucial decisions as they start incurring additional tax costs they had not anticipated when their projects were budgeted for. In addressing these costs, and additional reporting requirements due to complexities in the South African income tax legislation and the legislation applicable to the country of assignment, employers may need to revisit mobility policies.

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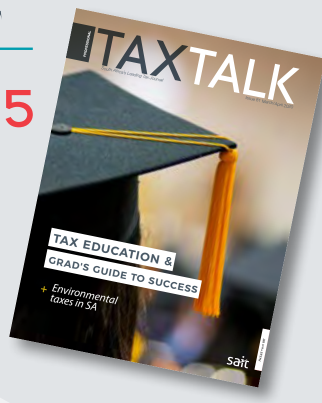

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EXPAT EMPLOYEES & THE PAYROLL NIGHTMARE

TARRYN ATKINSON, tarryn.atkinson@firstrand.co.za

Employers with employees stationed abroad face a dual system of tax collection – the foreign revenue authority and SARS. Tax credits are applied to avoid or mitigate double taxation. How is this managed on a monthly payroll system? Our article will show you how this is done.

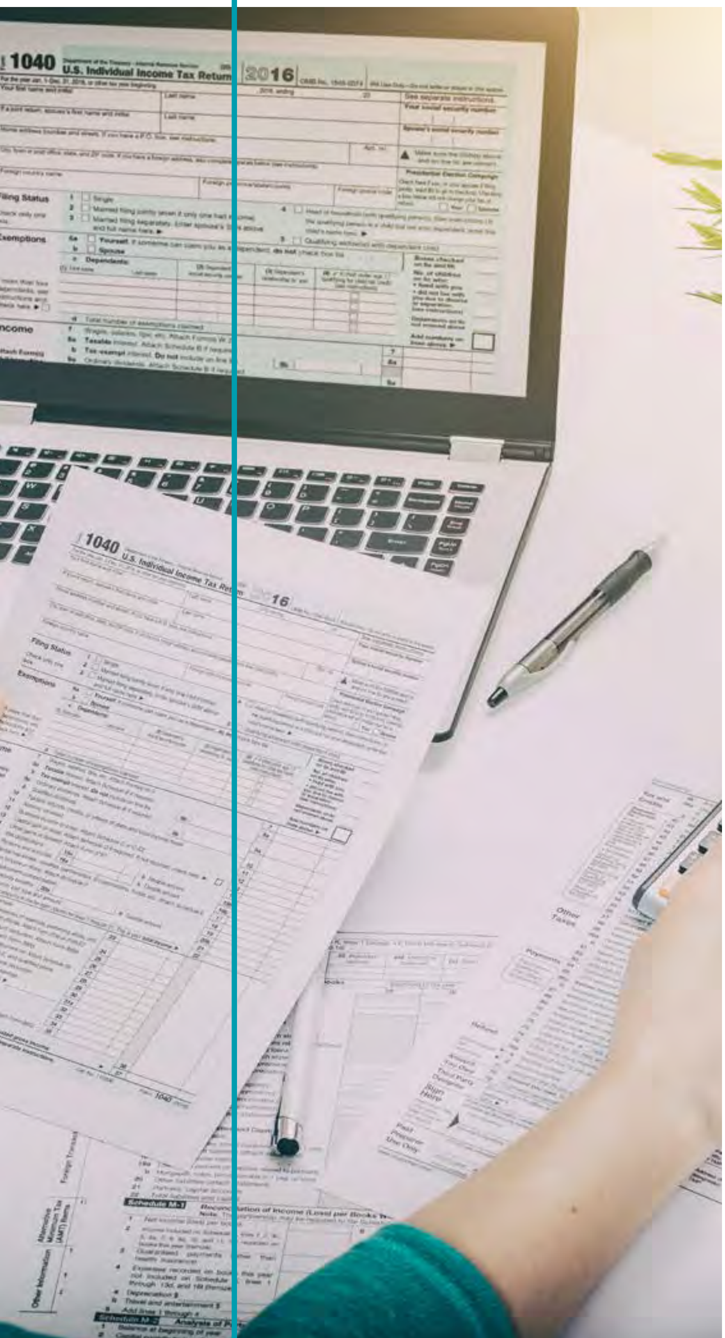
Managing expatriate employees on payroll has always been a complex and onerous task. The variety of remuneration structures, assignment structures and various tax policies that can be applied by employers make the calculations and reporting of expatriate earnings on IRP5 certificates a time-consuming and largely manual process.

With the revision of the exemption in section 10(1)(o)(ii) of the Income Tax Act that came into effect on 1 March 2020, the complexity and burden have increased substantially. This is particularly true for those employers that retain their outbound expatriates on a South African payroll.

Impact on payroll

There are very few payroll systems that can adequately deal with the complexity of a tax equalised assignment: accounting for the hypothetical taxes calculated and reporting the amounts correctly under the SARS income codes. Even if not applying a tax equalisation policy, the requirement from SARS to reflect both the foreign and local remuneration on the IRP5 in order to be able to claim the section 10(1)(o)(ii) exemption adds to the complexity. This information is usually only available after tax year end and then requires manual adjustment to the IRP5 and resubmission of the certificates to SARS.

Under the revised exemption employers that retain outbound expatriates on the local payroll will be obliged to withhold PAYE. While that seems simple enough there are a number of factors that need to be considered. The employer will have to calculate the value of the foreign remuneration, determine the rate at which to translate the value and then determine if the exemption is applicable and to what extent. The balance remaining is the taxable amount: tax will need to be calculated and, if applicable, foreign tax credits applied to determine the tax actually due to SARS for the month.



Payroll is a largely automated process under normal circumstances but there is a significant amount of manual intervention required in order to process the foreign remuneration and foreign tax credits on payroll to get to a final result. The complexities of this are set out in the discussion that follows.

Determining remuneration

The first step is to determine the value of the remuneration to be included in the calculation. This includes both cash-based payments and benefits provided to the expatriates, and this is where some complexity arises. Certain benefits in foreign jurisdictions are not taxable in those jurisdictions. However, under South African law the benefit would be taxable and would therefore meet the definition of "remuneration" in the Income Tax Act. This creates a dual calculation that must be done to determine the value that needs to be reported as foreign remuneration.

This calculation is not a new occurrence. In cases where expatriates do not meet the required number of days, this calculation is performed in order to support the claim of foreign credits that would be claimed on assessment. In these cases it is done as a once off calculation for tax return purposes and not monthly.

Another factor that complicates the calculation is where a benefit in a foreign jurisdiction is not taxed at its face value but is subject to a formula-based calculation and that calculation differs as to how the benefit would be valued in South Africa. For example, accommodation might be taxed at 5% of the value of the property in Nigeria, whereas in South Africa there is a complex formula based on prior year remuneration values and on how many rooms the property has. These kinds of anomalies create much uncertainty in the payroll environment.

The value of the remuneration must then be converted from the foreign currency into local currency in order to be reflected on the monthly payroll. The rate at which the value must be converted must be applied consistently. As the payroll is a monthly process the relevant provision, section 25D of the Income Tax Act, requires the translation to be performed at the spot rate on the date the amount accrued to the employee (i.e., payday).

> "As can be seen the costs, risks and administrative burden on employers and on the payroll system and processes are enormous."

Applying the exemption

The next consideration is the application of the R1.25 million cap. Section 10(1)(o)(ii) provides for a R1.25 million exemption if the employees have met the required number of days prescribed in the legislation. In order to apply the exemption on the payroll the employer will need to make an assumption, hopefully an informed assumption, that the employee will meet the requisite number of days before any calculation can be performed. This is not an unusual assumption, as under the previous version of the exemption, employers would apply the same principle in order to determine whether PAYE would be payable on the foreign remuneration. They would then apply their discretion as to whether to deduct PAYE or assume that the exemption would be met.

The SARS guidance provides that the exemption is cumulative and as a result could be used up in a single month should the value of the remuneration be significant. This means that the employer will need to track the balance of the exemption in order to apply it correctly each month thereafter. There are many who believe that the exemption should be spread evenly throughout the year. However, this would require a legislative amendment and that has not been promulgated nor announced in the National Budget Speech.

Once the exemption has been applied, the value that remains is the taxable amount. On this value South African income tax is determined based on the tax tables. Now the employer has a value for the tax that would have been due on that remuneration had the amount been earned in South Africa.

Foreign tax credits

The next step is to determine whether foreign tax credits are applicable or what portion of foreign tax credits could be applicable in order to offset the tax due.

The application of foreign tax credits on payroll is a new concept. SARS has implemented a new directive process whereby employers can request a directive from SARS determining how they will apply the foreign tax credits on a monthly basis via payroll. The application requires the employer to set out the methodology that will be applied in order to calculate the foreign tax credits and how these will be applied to the tax due on the taxable amount.

The complexity with foreign tax credits is determining the evidence on which the credit will be based and what is included in the tax paid or payable value. It seems to be generally accepted that social security based taxes will not be regarded as foreign taxes paid for this purpose.

Further to that, the foreign tax credit must be applied proportionately against the taxable income. This means that if 50% of the income is exempt by applying the R1.25 million exemption, then 50% of the foreign tax credits cannot be used to offset the tax due.

This is important. As mentioned previously, some benefits are not taxable in certain foreign jurisdictions but would be taxable under South African tax law. This means that no tax has been levied on those benefits, i.e., there is no foreign tax credit to apply, thereby rendering them fully taxable in South Africa.

Once the employer has an approved methodology this is not a final determination of the foreign credits that will be allowable as the determination of foreign tax credits applied against tax due is made only on assessment. The risk then is that on assessment SARS may disallow some of the foreign tax credits that the employer has allowed on payroll. This would therefore mean that there is a shortfall of PAYE and the employer may be concerned as to whether SARS will levy interest and penalties on the shortfall. One would hope that the directive would provide the employer with a level of protection from this but, as this process is still new, it will need to run its course a few times to see how SARS will approach any shortfalls that arise.

Tax due

So now the employer has determined the amount of tax due to SARS. If the employer processed the cash salary in South Africa, there may be cash from which to take the additional tax due. However, if there is not enough cash to settle tax due, the employer ends up in a difficult position. The tax is due to SARS on a monthly basis but if there is insufficient cash to withhold on, the employee will become indebted to the employer. That in itself creates another complexity and a new fringe benefit may arise in the form of a low-interest or interest-free loan or, in the alternative, the settlement of an employee debt.

For employers that apply a tax equalisation policy for their expatriates this cost is twofold. The taxes due on assignment, regardless of where they arise, are the obligation of the employer. As a result the additional tax due in South Africa will be the employer's sole responsibility, and will need to be accounted for in the complex calculations that are part and parcel of a tax equalisation methodology.

Provisional tax

For employers that do not retain their expatriates on the local payroll but move them to the host payroll, the matter is not less complex but it is less frequent. The expatriates will need to perform these calculations at provisional tax time (i.e., twice a year). The payrolls will, however, have to be able to provide the expatriates or the tax service provider with the relevant information regarding remuneration and taxes paid in order to enable the calculation to be performed for this purpose.

Other considerations

As part of the above scenario, the employer will still be required by the host country revenue authority to reflect the remuneration on that payroll, even if the payments are made here, and to still make all tax payments in the foreign jurisdiction. The employer will also have to collate all necessary proof of taxes paid, in order to facilitate the foreign tax credits that have been applied on payroll and may be queried by SARS on assessment.

The timing of these calculations is also critical, given the tight timelines that payrolls run on in order to ensure timeous payment to all employees (not only expatriate employees) and SARS as well as payments to third parties like medical aids and retirement funds.

As can be seen the costs, risks and administrative burden on employers and on the payroll system and processes are enormous. This will without doubt impact decision making on assignments, remuneration structures and tax methodologies going forward.

PROS AND CONS OF TAX NON-RESIDENT STATUS

30 minutes CPD

▶ **HUGO VAN ZYL**, hugovz@iafrica.com

Many South Africans working abroad for foreign employers (or foreign clients) are now asking their tax practitioners whether they should stay in the South African tax net. If they leave, what is the price? Our article provides some answers.

The question most posed recently to tax practitioners taking care of South African expats has been: When, if at all, should an expat consider leaving the South African tax net?

The recent reduction in the foreign employment income exemption, from a total exemption to a capped exemption, has led to taxpayers asking how to escape the new tax exposure. The easy answer is for these clients to become tax non-residents, as the capped exemption exclusively applies to tax resident expats working outside South Africa.

Individuals who are not tax residents are exempt from the new so-called "expat tax charge". All the foreign income accruing to tax non-residents that is not from a South African source, or deemed to be from a South African source, is tax exempt in South Africa.

Expats living in certain tax treaty countries may even escape South African tax on locally sourced interest income.

Leaving the tax net – what is the buzz?

The South African Income Tax Act charges tax on a resident's worldwide income, that is, also income from abroad. As of 1 October 2001, tax residents are subject to capital gains tax on most actual or deemed disposals.

Before 1 March 2020, there was no monetary restriction on the exemption for foreign employment income. Tax residents living and working abroad, for adequate days in any consecutive twelve-month period, could enjoy full exemption of their foreign employment income.

As of 1 March 2020 (therefore from the 2021 tax year), section 10(1)(o)(ii) of the Income Tax Act was amended to restrict or cap the exemption to taxable foreign employment income of R1.25 million. This means that foreign earned income above the cap becomes taxable income, to which the sliding scale income tax tables are applied. Resident expats have to continue complying with the 183-day requirement (and more than 60 consecutive full days) in order to qualify for the capped R1.25 million exemption.

The "escape from jail card" in this case is ceasing to be tax resident – also referred to as tax emigration. If the foreign country in which the person is employed has a double taxation agreement (DTA or treaty) with South Africa, this may be achieved by applying the rules contained in the double taxation agreement.

The DTA rules trump all

The Income Tax Act defines a resident to exclude any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the South African Government and the other country for the avoidance of double taxation, commonly known as a double taxation agreement.

In short, a person who is defined to be exclusively a tax resident of a country with which South Africa has a double taxation agreement (a treaty country) is not a resident for purposes of the Income Tax Act. This applies despite the "ordinarily resident" rules in the Income Tax Act.

The term "tax resident" is not defined as such in the Income Tax Act but is used here to clarify that we are not dealing with a resident in terms of Home Affairs or the exchange control rules of the Reserve Bank.

It is also essential to understand that certain treaties contain a treaty-specific definition of a resident, applicable to that specific treaty or double taxation agreement only. This does not change estate duty or VAT rules.

In some cases an individual is tax resident in both treaty countries, but OECD and United Nations treaties ensure or deem that each taxpayer is tax resident in one country only. Then one has to proceed to the treaty tie-breaker rules to establish which country has the right to tax the individual. Treaties usually grant global taxing rights to the tax-resident state, despite the source-of-income state having the first right to collect income tax at source.

Assuming the double taxation agreement provides for the necessary permission or deeming rules to cease South African tax residency, what then are the consequences, real cost and practical impact?

Tax consequences

A South African expat who is deemed by a double taxation agreement tie-breaker to be tax non-resident in South Africa can typically earn all their foreign employment income free of any SARS tax exposure. However, there is one final tax charge that the tax emigrating expat needs to deal with before serving the champagne.

"In short, a person who is defined to be exclusively a tax resident of a country with which South Africa has a DTA (a treaty country) is not a resident for purposes of the Income Tax Act."

The exit tax
In terms of section 9H of the Income Tax Act an "exit tax" is payable on global assets as well as cash held. Excluded are South African immovable properties held in the expat's own name. South African retirement funds and life insurance values are also not subject to the section 9H capital gains tax charge on unrealised gains.

The exit tax takes the form of capital gains tax on unrealised gains as the Income Tax Act deems the tax emigrant to have sold all assets at market value the day before ceasing tax residency.

What about future taxes?
The so-called exit tax may often be more expensive than initially meets the eye. Here is an example:

Siblings often hold their holiday home within a relatively dormant South African company, as they share the operating expenses outside the realm of the company.

Assume there are three siblings, each owning one-third of the equity and vote in the property company. The sibling ceasing to be tax resident now faces an exit charge on the unrealised gain on the more than 20% voting and equity right held in the near dormant property company. No real sale, yet a cash outflow of say 18% on one-third of the unrealised gain.

Two years later, the holiday home is sold. The capital gains tax event within the company triggers capital gains tax at 22.4% on the realised gain without the tax charge being reduced by past exit taxes paid. The only silver lining is that the non-resident shareholder's dividend withholding tax rate may be reduced to 10% or 15%, whereas the local siblings pay 20%.

Further complications
The scenario sketched above will be further complicated if, before the sale, a second sibling joined the first one in the same treaty country.

The result is that the South African property-rich company is now either a controlled foreign company or an effectively managed company in the new tax country where the majority shareholders reside.

Assume the remaining brother now wishes to buy the expats siblings' shares. The sellers, being non-resident shareholders, may face a capital gains tax withholding tax at 7.5% of the gross selling price in terms of section 35A of the Income Tax Act. The transaction is subject to the rules in paragraph 38 of the Eighth Schedule to the Income Tax Act. These rules force the parties to transact at market value and not at the shareholder agreed price.

It follows that physical departure from South Africa, linked to a double taxation agreement or treaty tax exit, may impact not only on the expats but also on the "remainers" or shareholders staying behind in South Africa. Section 35A places the capital gains tax withholding tax obligation on the buyer or the local lawyer, accountant or estate agent facilitating the share transfer.

The resident sibling is obliged to pay South African transfer duty on the two-thirds of the company shares now acquired. The market value paid for the shares acquired sadly does not increase or step up the base cost of the property within the company.

An expat in the UAE making use of the UAE treaty can escape the effect of the capped exemption only once he or she has sold all interests in South African abodes, whereby the Ejari leased apartment in Dubai becomes one's only abode permanently available.

We should timeously pan the impacts of the cessation of tax residency on enveloped properties and all remaining resident shareholders.

Other practical issues to consider
The South African Estate Duty Act exempts from estate duty a deceased who was "not ordinarily resident in the Republic at the date of his death", in respect of any right in immovable property situated outside the Republic. The Income Tax Act refers to a "resident", which includes a person ordinarily resident in the country. Yet the Estate Duty Act refers specifically, without defining it, to a person that is "not ordinarily resident".

Being tax non-resident based on a treaty position does not require a change in ordinarily resident status. SARS confirms in Interpretation Note 3 that an individual can be tax non-resident while remaining ordinarily resident in South Africa.

It follows that one can reside free from South African income tax, donations tax and capital gains tax in, say, the UAE while remaining ordinarily resident in South Africa. An expat deemed to be exclusively resident in Dubai for income tax purposes can escape direct income taxes. Yet, South African estate duty may be payable on non-South African assets obtained from after-tax tax-free income earned in the UAE.

Will formal emigration switch off this estate duty exposure? The quick answer is: probably not. Formal or financial emigration is nothing more than an undertaking not to return to South Africa for the next five years.

Was the hype necessary?
The question then is: Was all the hype and new expat tax law worth it? Probably not. The "double tax-exempt" expats can escape the new rules, availing themselves of a treaty. As most left South Africa because they had very little in the country, the revenue from exit tax is not significant. If expats avail themselves of treaty rules, this removes any hope of collecting tax on the income of these untaxed expats. The new expat tax law only serves to complicate all the other tax law rules not addressed at the same time.

The Tax Faculty

MANAGING CORPORATE INCOME TAX
MAY 2020

Assisting the tax practitioner in due diligence when preparing the IRP6, the ITR14 and the IT14SD.

WEBINAR

4 HOURS

OVERVIEW

The primary responsibility of the tax practitioner with regard to the submission of the IRP6, ITR14 and IT14SD is to ensure that complete and accurate information is submitted to the South African Revenue Service (SARS) and that defendable positions are taken whenever Uncertain Tax Positions arise.

This webinar is directed to assist the tax practitioner and his/her client to ensure that corporate income tax returns are submitted in such a manner as to create tax certainty, reduce the risk of understatement and underestimation penalties and to anticipate SARS requests for information and audits. A proactive approach to IRP6, ITR14 and IT14SD's will facilitate the dispute resolution process.

PRESENTER

Johan Heydenrych
MCom Tax & CA (SA)

Areas of expertise:
Corporate tax, value-added tax, employment tax, tax accounting, tax process and technology.

DATES

13 May
20 May
27 May

Time: 09:00–13:00

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THE UNCERTAIN FUTURE OF FINANCIAL EMIGRATION

▶ **JONTY LEON,** jonty@taxconsulting.co.za &
REABETSWE MOLOI, rea@taxconsulting.co.za

Our article looks at the move by South Africans working abroad to take themselves out of the SA tax net, against the background of the recent cap on a longstanding exemption for workers who venture outside the country's borders.

A quick recap for newcomers to taxation of South Africans abroad: After a policy lasting nearly two decades of giving an employment tax exemption to South Africans performing employment services abroad, there was a material policy shift by National Treasury and SARS. A first proposal to completely remove the exemption was adjusted to cap the exemption at R1 million (now R1.25m) of earnings.

Resistance to this tax law change was spearheaded by Barry Pretorius who formed the Expatriate Petition Group – credited with getting the complete removal of the exemption reversed, while being one of very few voices in fighting for expatriate rights.

The numbers do not add up

One of the primary reasons advanced in Parliament by National Treasury and SARS for the law change was non-compliance by expatriates. They indicated that expatriates claiming the foreign employment exemption averaged less than 4 800 per year. Such a number for tax compliance makes no sense, in view of the vast numbers of South Africans working abroad. Also, having done thousands of tax diagnostic exercises on expatriates, the simple truth is that SARS is correct and widespread non-compliance by South Africans abroad is the order of the day.

Pointing fingers

The expatriates' reasons for non-compliance are countless. However, a significant portion blame their tax advisors (often correctly so), something which should trigger professional negligence and unprofessional conduct cases. Other reasons regularly given include:

- Being advised by unknown SARS frontline officials to submit zero tax returns
- The fact that SARS never previously had an issue with their zero tax returns
- Most worryingly, the "how will SARS find me?" narrative that has a popular following

Exit foretold

The effects of this amendment were immediately telling as thousands of South African expatriates who were affected by the change made plans to exclude themselves from the tax base by ceasing their tax residency. This should not have come as a surprise, as this was simply the fulfilment of a prophecy by many stakeholders. Yet, despite specific warning to National Treasury that taxpayers would accelerate cessation of tax residency if this punitive regime was implemented, National Treasury responded by stating that the formalisation of tax residency status of those South Africans living abroad was to be encouraged.

Carrot and stick approach

The carrot

In the 2020 Budget Announcement, a carrot was dangled in front of South Africans abroad, perhaps in an attempt to retain those that were leaving the tax base. It was announced that the cap on the foreign employment exemption would be increased to R1.25 million. In the same breath, Government encouraged those affected to "maintain their ties to the country" and indicated that the concept of "exchange control emigration" would be phased out by 1 March 2021. One can speculate why Government would like to maintain ties with its subjects, but a good guess would be that it is very much aware that a cherished segment of its tax base is shrinking, as high-earning expatriates formalise their non-resident status.

Terminating exchange control emigration – for unknown reasons – is peculiar considering the following:

- This is an old enacted law which provides clarity on exchange control status. It is unclear how future exchange control status will be determined and new regulations will be required.
- The exchange control emigration process has recently been enacted in the Income Tax Act. This points to a recent change in policy or tactics. The tax law changes will have to be reversed and new ones enacted.
- South Africa participates in automatic exchange of information (AEOI) between countries, mainly tracking taxpayers' global bank accounts. Under, for example, the Common Reporting Standard (CRS), a global tax evasion initiative, South Africa is informed of all South African bank accounts, often regardless of whether they are resident or non-resident for tax purposes.

The stick

Expatriates would correctly be questioning the motives behind this change and whether this is indeed only to help and make things simpler. Delving into the finer details of the Budget 2020/21, there are various pointers on what the future financial emigration process will look like.

- There will be a "strengthening [of] the tax treatment". Whilst details of this are unknown, one can only support any initiative which is aimed at strengthening legal certainty and supporting a more compliant approach.
- It was announced that a "more stringent verification process" will be followed. It may be argued that the exchange control emigration process is complex enough. We have also seen some deeply in-depth and excellently conducted SARS audits, at the Emigration Tax Clearance stage, which is a necessary component of getting Reserve Bank approval. The plan to make this more stringent should be alarming for expatriates, to say the least.
- The addition of a "risk management test" was announced, which suggests that currently there is no such test for SARS when issuing their emigration tax clearance certificates. We are not sure if this is correct, as we have seen some detailed audits conducted as part of the financial emigration process. Our best explanation, before further formal announcements, is that each and every expatriate will be required to undertake a risk management test.
- There will be a "certification of tax status". These terms would make any taxpayer nervous and pay attention. One would be forgiven for saying that any certification process by SARS is not a walk in the park – remember the old days of IRP30 labour broking exemption certificates and dealing with the Tax Exemption Unit. We are not necessarily critical – where SARS has focussed professionals, there is always better application of the law but that almost always means compliance and enforcement are tougher.

The only solution is to act

The first tax payment for expatriates, under the new "expat tax" is before 31 August 2020, when their first provisional tax payment is due. As it stands, South Africans abroad have until 1 March 2021 to make use of the current and accepted "financial emigration" process.

We have seen an acceleration in applications for financial emigration by expatriates since the Budget 2020/21 announcement. It serves an expatriate who has genuinely emigrated to formalise their fiscal status with authorities under a certain regime. The formalisation of tax status of South Africans abroad is not something to be put off until the expatriate is audited. It is critical to have the courage to have your SARS status checked, as opposed to lying awake at night waiting for your number to come up.

What the future from 1 March 2021 holds for South African expats is uncertain but the message appears rather clear that they will be faced with a more complex "certification of tax status", which will include a "risk management test" and a "more stringent verification process".

30 minutes CPD

THE NEW EXPAT TAX VS SARS AUDIT STRATEGIES

JEAN DU TOIT, jean@taxconsulting.co.za

In the context of the COVID-19 pandemic, a faltering economy and reduced tax revenues may well compel SARS to look to new areas from which to raise revenue to fund a greater need for Government services. Our article considers whether South Africans working abroad will be seen as an easy target and how tax practitioners can prepare for this.

The amendment to the exemption for expatriate workers in section 10(1)(o)(ii) of the Income Tax Act came into effect on 1 March 2020, after years of arm wrestling over it. From the complete repeal of the exemption initially proposed there was a move to a capped exemption, followed by an unexpected increase in the exemption limit in this year's budget.

The first tax payment deadline is around the corner, with the first provisional tax payment due on 31 August 2020. National Treasury and SARS bosses will watch with interest whether there is indeed much tax revenue being handed over, by reluctantly compliant expatriates, or if this will not be as easy as they hoped. Significant fiscal resources have gone into this change, and they noted in Parliament non-compliant expatriates as the primary reason for effecting this massive policy shift. For my fellow practitioners reading this with a critical eye and pointing out that there is no provisional tax where there is South African employees' tax my rebuttal will be that, by and large – and taking into account the mammoth task of setting up a fully compliant expatriate payroll (SARS directives for foreign tax credits, fringe benefits all correctly determined and section 6quat correctly computed) – expatriates with a tax liability must be registered as provisional taxpayers.

We do not foresee the expatriates easily handing over their provisional taxes and, as tax practitioners know, the SARS eFiling system works excellently when it comes to the computation of penalties and interest on non-payment or underestimated taxes. This means expatriate tax compliance is a risk for tax practitioners, as tax malpractice claims are an increasing threat. Perhaps SARS does not always give the tax fraternity the credit they deserve for the hours they spend convincing taxpayers to do the right thing and correctly pay their taxes.

This raises some interesting tax practice management questions and expatriates themselves need to appreciate what they should expect. Perhaps this day will only come when the expatriate is back home, even "safely" retired, and a skilled SARS auditor approaches with a surgical blade.

What makes you think SARS will audit expatriates?

When the world was still pre-COVID-19, when this law change was debated in Parliament, a key submission on the part of National Treasury and SARS was that less than 4 800 returns were submitted claiming the foreign employment exemption under section 10(1)(o)(ii) of the Income Tax Act. A comparison was made with the number of individuals who had completed financial emigration through the South African Reserve Bank and the statement was made that the numbers did not add up. The number of expatriates who formalised their emigration and those who submitted returns was meagre in comparison to the hundreds of thousands of South Africans reportedly working abroad. Simple math dictated that expatriates are simply not disclosing their foreign earnings and that those who have left for good have not paid their capital gains tax exit charge, as basic examples. In simple terms, this is a sore point for SARS and expatriates will no longer be allowed to operate unchecked and unchallenged.

Moreover, in the new post-COVID-19 period, SARS will find South Africans even more cash-strapped. Having an expatriate client base that earns predominantly dollars or harder currency comes down to the principle of low-hanging fruit.

Also, there is already a dedicated unit within SARS specialising in expatriates, so the focus area is there. On the strength of CVs we receive, many expatriate tax and global mobility specialists are looking for work, so upskilling should be easier than, for example, for the BEPS initiatives.

SARS audit risk identifiers

The first audit risk identifier for SARS is the uniformity of expatriate employees. Whilst there are various categories of expatriate arrangements, they can easily be sorted into approximately 12 categories and SARS can have a uniform standard, which makes them easy to audit.

Example: where you have a South African resident seconded to Nigeria or Angola, on rotational basis, fixed term by a South African employer, the package details are hardly a secret. The most commonly found items will be a currency-denominated agreement, so conversion rates must be checked. There will be flights there and back, housing with all the trappings will be provided, transport will be a given,

there will almost always be a security detail, housekeeping, a driver, medical aid, medical evacuation and even tax services where a large employer group is involved.

The second compelling reason is that expatriates are easy to find, by simply practising the law of following the money. They earn abroad and remit forex home, all coded and reported. SARS may have had difficulty accessing passport control records in the past (we have not seen it happen) but in a post-COVID-19 era expatriates can no longer rely on one government not talking to another. SARS will have to do whatever it takes to ensure the tax gap is closed – the law is in place and it is simply a matter of audit and enforcement.

SARS' access to information

SARS can access information about expatriate taxpayers from any or all of the sources below.

Bank statements

The most basic of strategies would be for SARS to check bank statements, to verify if those who disclose their foreign earnings do so correctly and, also, to detect those who fail to do so.

Financial Intelligence Centre reported transactions

The Financial Intelligence Centre Act creates stringent reporting obligations for certain transactions, specifically for cash transactions of R25 000 or more. Where a South African working abroad transfers their salary or a portion of it to South Africa, this will be reported in terms of the Financial Intelligence Centre Act. A simple, yet effective, audit strategy will be for SARS to review these Financial Intelligence Centre reported transactions against their records, to detect those who are not in the system currently.

Common Reporting Standard and Panama Papers

The first reporting under the Common Reporting Standard was set for September 2017. Most European countries and South Africa committed to start reporting in 2017, with the rest committing to do so in 2018. To date, however, we have not seen any arrests or convictions in South Africa under the Common Reporting Standard and by all accounts this mechanism appears underutilised by SARS. In the same vein, the Panama Papers revealed 1 666 cases linked to South African residents and, on SARS' account, a large portion of these relate to individuals. We have not seen any evidence of action on this either, but these persons may

> *"Expatriates are simply not disclosing their foreign earnings and those who have left for good have not paid their capital gains tax exit charge."*

all have entered the Special Voluntary Disclosure Programme. Strategically, these initiatives should be some of the primary arrows in SARS' quiver in detecting those who are not in the system at this point. Where it is revealed that a person holds offshore investments, SARS can easily verify if the individual disclosed their foreign income and/or if they paid their capital gains tax exit charge when they left South Africa. It remains to be seen, however, whether SARS will execute on this, as they have publicly stated they will have a proper look at these individuals.

Fringe benefits

A large component of expat remuneration is made up of fringe benefits. SARS has unequivocally stated that these will be quantified and taxed in accordance with our domestic tax legislation. It would be a safe bet to say that this will be an area that will receive special attention from SARS, especially given the large degree of uncertainty around it. To ensure these benefits are quantified and disclosed correctly, SARS may ask for the employment agreement or other documents that outline the relevant benefits. An easy and brutal approach for SARS would be to put it to expats to prove that the quantification of these benefits was done correctly. In certain circumstances this may be very difficult, especially where the fringe benefit is not taxable in the host country.

Targeting employers

An alternative to pursuing the individual would be for SARS to turn to the employer to take this on from a payroll perspective. From SARS' point of view, this is less burdensome because the Tax Administration Act affords them the choice of going after the employee or the employer for any PAYE. We have seen SARS do this and the general audit questionnaire asks for a wide range of documents and information, including a list of expats, mobility policies, employment agreements, explanation of the remuneration methodology and a list of fringe benefits provided. The questionnaire, in itself, can become the bane of any employer's existence if they are not prepared for this.

Housing register

The Commissioner has noted that he wants to use the housing register to address the apparent non-compliance among those who have rental properties. This is an effective strategy that can be deployed to find non-compliant expatriates as well. Many South Africans who go on assignment abroad, for various periods, tend to retain their residential properties. The rationale can be a combination of the fact that they intend to return to South Africa and the stagnant property market. In any event, comparing the housing register with SARS records will be killing two birds with one stone.

Now we wait

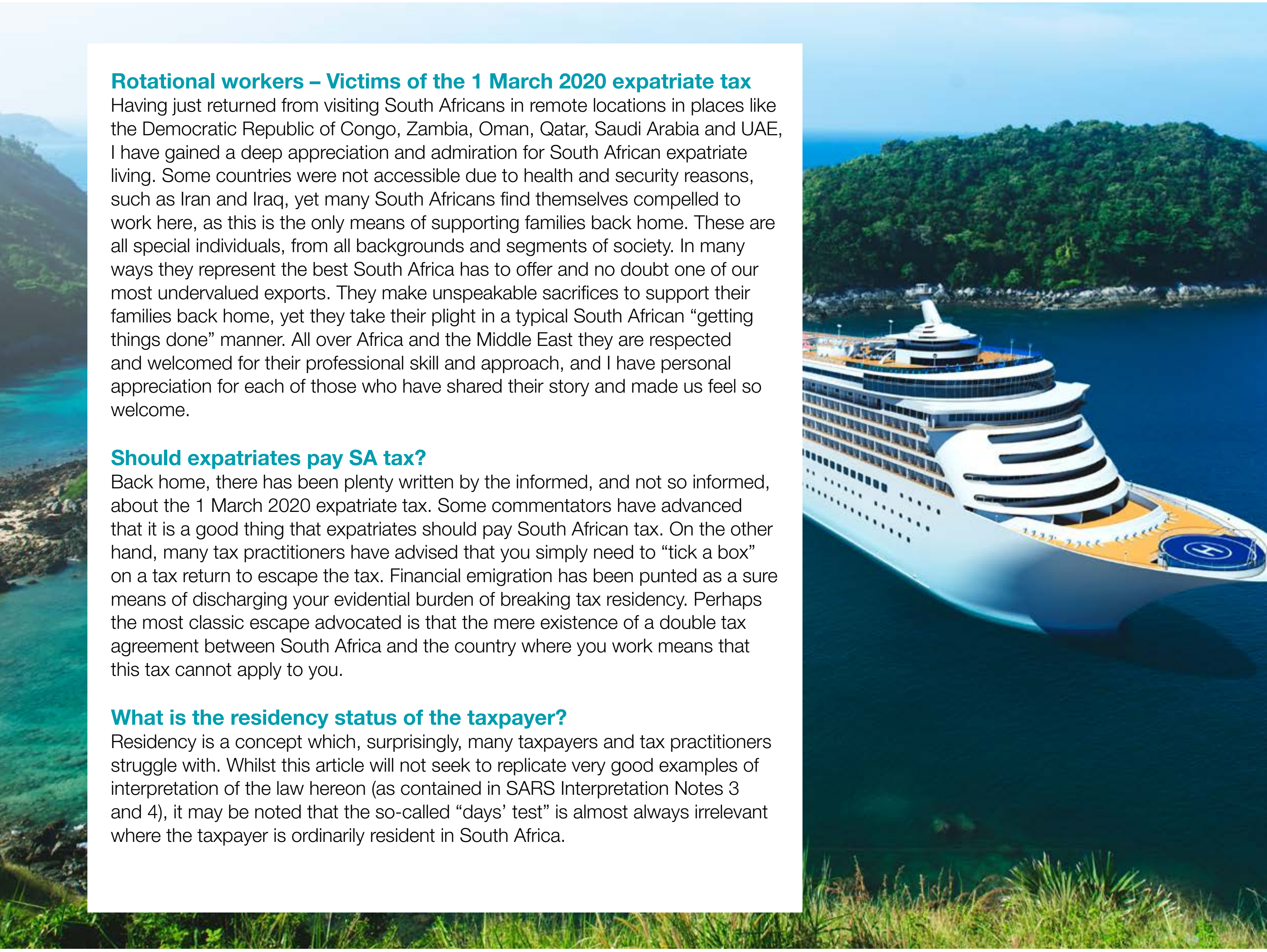
As tax professionals, it would be interesting to see how ingenious SARS will be with this. A skilled SARS official can easily overcome prescription, so any non-disclosed income, even where exempt, creates a permanent target for SARS. Tax practitioners should especially be aware that they have full risk sign-off from expatriates, as expatriates may quickly place the blame on them when there is heat.

Tax practitioners have to ask S planning or tax compliance service; and we may see an increase in resignation of professional firms from expatriate tax engagements for professional reasons.

EXPATRIATE TAX FOR **ROTATIONAL WORKERS AND SEAFARERS**

▶ **JOHNNIE KRUGER,** johnnie@taxconsulting.co.za

Our article takes a closer look at the supposedly luxurious lifestyle of some South African expats working abroad as rotational workers and seafarers or those working abroad to retire in South Africa.



Rotational workers – Victims of the 1 March 2020 expatriate tax

Having just returned from visiting South Africans in remote locations in places like the Democratic Republic of Congo, Zambia, Oman, Qatar, Saudi Arabia and UAE, I have gained a deep appreciation and admiration for South African expatriate living. Some countries were not accessible due to health and security reasons, such as Iran and Iraq, yet many South Africans find themselves compelled to work here, as this is the only means of supporting families back home. These are all special individuals, from all backgrounds and segments of society. In many ways they represent the best South Africa has to offer and no doubt one of our most undervalued exports. They make unspeakable sacrifices to support their families back home, yet they take their plight in a typical South African "getting things done" manner. All over Africa and the Middle East they are respected and welcomed for their professional skill and approach, and I have personal appreciation for each of those who have shared their story and made us feel so welcome.

Should expatriates pay SA tax?

Back home, there has been plenty written by the informed, and not so informed, about the 1 March 2020 expatriate tax. Some commentators have advanced that it is a good thing that expatriates should pay South African tax. On the other hand, many tax practitioners have advised that you simply need to "tick a box" on a tax return to escape the tax. Financial emigration has been punted as a sure means of discharging your evidential burden of breaking tax residency. Perhaps the most classic escape advocated is that the mere existence of a double tax agreement between South Africa and the country where you work means that this tax cannot apply to you.

What is the residency status of the taxpayer?

Residency is a concept which, surprisingly, many taxpayers and tax practitioners struggle with. Whilst this article will not seek to replicate very good examples of interpretation of the law hereon (as contained in SARS Interpretation Notes 3 and 4), it may be noted that the so-called "days' test" is almost always irrelevant where the taxpayer is ordinarily resident in South Africa.

Double tax agreements determine tax residency

Where a taxpayer is tax resident in both South Africa and a foreign jurisdiction, and there is a double tax agreement with the other country, the double tax agreement overrides South African domestic law. This override is, quite uniquely, incorporated in the definition of "resident" as defined in section 1 of the Income Tax Act. But I will leave this for the tax technocrats to debate.

What is important is that you can break tax residency by using a double tax agreement. This is very important for those expatriates who want to use the double tax agreement between South Africa and another country to claim the expatriate tax does not apply to them. This is, however, easier said than done, considering the aspects below.

- The taxpayer must claim tax relief under a double tax agreement, i.e., this is not something you automatically qualify for. It is a claim to be done every year!
- The expatriate must prove, each tax year, that they are resident in the other treaty country. This is normally done by obtaining a "tax residency certificate" in the other country, which can range from an easy and free process to a complex and costly process. Many double tax agreement countries do not even issue these certificates!
- The tax residency certificate and existence of a double tax agreement are not the end of the process but actually only the start. The taxpayer must then prove to be exclusively resident in the other country using the so-called tie-breaker clause.

Tie-breaker clauses

The analysis of a tie-breaker clause can fill up a chapter in a textbook by itself, so will not be discussed here. What is important at a practical level is that its applicability is a moot item in the case where a taxpayer cannot pass some basic tests. Explained differently, the types of taxpayers we are dealing with here, by the very nature of their duties and mode of life, will normally not qualify for the double tax agreement relief.

This means the expatriate tax taking effect on 1 March 2020 will mostly apply to them. Taking into account the types of benefits they receive, concomitant with the nature of their employment services, this is a high-risk area of tax filing: for both tax practitioners and expatriates themselves.

Expatriate workers may be placed in the broad categories discussed below.

Working abroad to retire in South Africa

There are many expatriates who accept the sacrifices of expatriate life in order to have enough money for retirement in South Africa. Thus, they accept the incredible sacrifice for a period, to ensure they have enough to retire and would not burden the state. They normally rotate back to South Africa and often already have a home here, in which they plan to retire. This category will probably be one of the hardest impacted by the expatriate law change, effective 1 March 2020 onwards.

Rotational workers

Expatriates in remote regions typically work on a rotational basis, similar to workers in mining, construction, oil rigs, ships or any other rotation. A typical scenario is where they work six weeks outside and have two weeks of rest and recuperation, during which they can return to their families in South Africa.

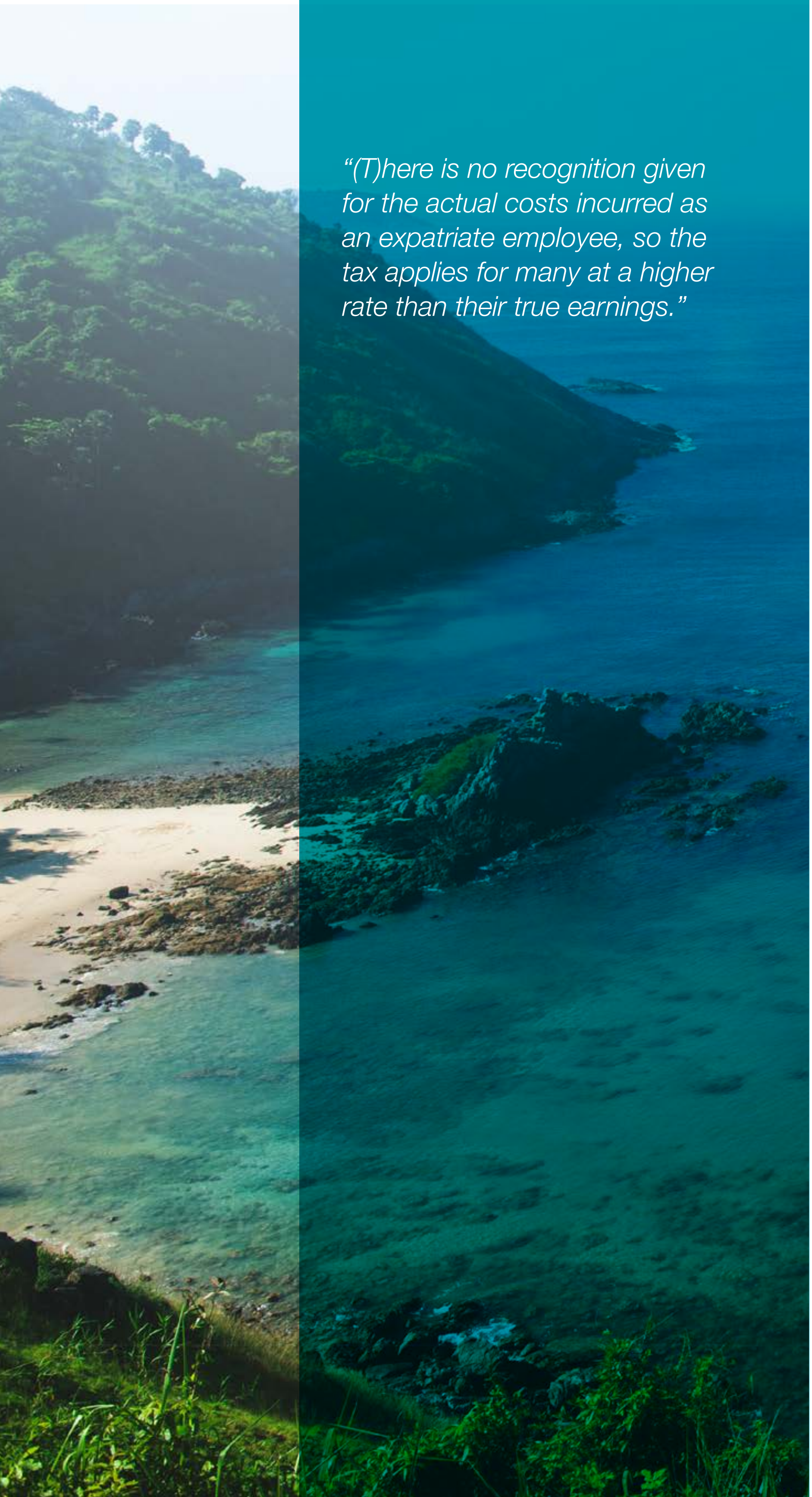
They will all be directly impacted by the expatriate tax. Especially the fringe benefits offered to them will cause a significant tax hardship; even though they do not get any economic benefit from these "deemed" tax benefits. To name some examples: transport, personal safety and security, accommodation. These will be a minefield for these expatriates and their tax practitioners to navigate. There are special exemptions on certain benefits, but this remains a highly specialised area of tax.

Seafarers

Attractive salaries lure skilled South Africans to take up employment on vessels and private yachts. As promising as this lifestyle may look, it is challenging from both a physical and mental perspective. On social media one always sees the luxury lifestyle of these expatriates working on cruise liners or private yachts. However, no-one ever sees the long working hours, small living arrangements and endless weeks on international waters away from their homes and families. In most circumstances this is all but a smooth sailing experience.

The seafarer exemption in section 10(1)(o)(i) of the Income Tax Act has not been changed but this exemption finds very limited application in practice. By far the majority of expatriates who are seafarers or who perform related work do not meet the requirements of the seafaring tax clause. This means they fall under the normal tax regime in South Africa and are treated as normal expatriate employees.

They can rarely claim non-residency, as due to their mode of life they are not resident anywhere else and effectively live on ships and return to South Africa during breaks.



"(T)here is no recognition given for the actual costs incurred as an expatriate employee, so the tax applies for many at a higher rate than their true earnings."

Thank you, Barry Pretorius

The Barry Pretorius initiated Facebook "Tax Petition Group" formed a remarkable lobby to turn a complete abolition of the expatriate tax exemption into the exemption being retained, albeit with a R1 million tax limit. This was a significant concession, showing most of the tax community wrong. They wrote it off as having no chance of success, resulting in pretty much no-one pitching up at the Parliamentary hearings.

Budget Speech announcement 2020

Minister of Finance, Tito Mboweni, announced in his Budget Speech on 26 February 2020 that Government will increase the cap on the exemption applicable to foreign employment income earned by South African tax residents from R1 million to R1.25 million per year, as from 1 March 2020. This was welcomed by many, but the more astute have quickly computed that this barely makes up for the weakening of the South African rand against the United States dollar. This benefit has simply been more than eradicated by the weakening rand against other global currencies.

The build-up to what should have been an extra pool of revenue collection has seemingly backfired. The increase of the exemption cap indicates Government's attempt to persuade South Africans working abroad against cutting their ties with South Africa. The underlying message translates to "please remain a South African tax resident so that we can tax you". The recent plunge of the rand and the taxing of employer-provided "benefits" will erode the foreign employment exemption, resulting in an unaffordable tax exposure in South Africa for expatriates.

When tax relief means paying higher taxes

Moving all theories aside and looking at the facts, expatriates mostly earn in US dollars and they will have a much higher South African tax burden, despite the increase in the exemption, due to the weakening of the rand.

	DOLLAR/ZAR	EXEMPTION (ZAR)	USD EQUIVALENT
DEC 17	14	1 000 000	71 428.57
APR 20	19	1 250 000	65 789.47
Amount no longer exempt:			-5 638.10

- The USD/ZAR conversion rate was below 14 in December 2017, when the law was promulgated, so these figures are conservative estimates.
- Some may be quick to point out that this means the expatriate earns more also, but that is fatally flawed as their expenses are also in US dollars.

This gets to the core of why this remains an inequitable tax regime: there is no recognition given for the actual costs incurred as an expatriate employee, so the tax applies for many at a higher rate than their true earnings.

Fringe benefits ignored

The real critical issue for expatriates is the so-called “fringe benefits” which they receive when working abroad: on a ship or at a remote site or location. Let us be clear, these are not genuine fringe benefits to anyone who has visited these locations. Yet they are defined as fringe benefits under our domestic tax law. Thus, whilst economically there are no real benefits being provided, the expatriate will be fully taxed on items such as accommodation, security, vehicle, drivers, medical facilities, evacuation and other insurances and flights home.

National Treasury and SARS are acutely aware of this issue and they know that expatriates were pleading for an exemption on various benefits. Yet none has been announced and will clearly not be given. This is the one area where understanding for the expatriate plight could have been shown. Under this regime, where one fails to proactively put the right tax planning measures into place, the only relief available to these expatriates is the allowable deductions and foreign tax credit claims under section *6quat.* This does not offer much relief when it comes to determining the actual tax exposure in South Africa. The section *6quat* relief mechanism is also more limited than what many believe and a very complex tax computation.

Where does this leave breadwinners and their families?

The focus on South Africans working abroad, such as rotational workers and seafarers, confirms that they rank high on SARS’ radar. Even more so in these challenging economic times, SARS will keep a tight rein on South African expatriates and their world-wide income. The expatriates who cannot claim relief – by means of breaking their ties with South Africa and formalising the process through financial emigration or claiming relief under the double tax agreements – have to carefully plan their tax affairs going forward. We will see SARS focusing on them as the new revenue providers.

There are also various tax scams doing the rounds, promising tax exemption which simply does not exist. A classic one is that you pay your whole salary to some unnamed offshore company and then a “dividend” appears in your bank account, which is claimed to be tax free. This is a simple case of tax fraud, so one will need to see what SARS does about this and what their strategies are to stop this.

EXPATRIATE TAX

A look at the new book released by LexisNexis and Tax Consulting that deals with the complexities of tax relating to South African citizens working abroad and foreigners in South Africa.

This book deals with a very niche and increasingly relevant area of taxation and is the first publication of its kind in South Africa. This specialised work provides a comprehensive technical and practical guide to South African tax for:

- individuals with their feet in more than one country;
- anyone involved with South Africans abroad or with international interests; and
- foreigners working, relocating to or otherwise investing in South Africa.

The novelty of the content extends beyond the core focus area, in that the authors focused on expanding on aspects where other academic guides have not yet ventured. These include principles of interpretation of fiscal legislation through the prism of the Constitution and extensive reference to the development of different provisions and commentary thereto. All of these form part of a more modern and purposive approach to tax law as a whole. The fresh and insightful perspective provided on payroll taxes throughout the text is also something that deserves special mention.

Whilst the core subject matter of the book deals with a dimension of international taxation, it equips the reader with a meaningful and complete understanding of the fundamental principles of South African tax law. It manages to do so without delving too deeply into concepts addressed by other LexisNexis publications.

It is evident that the authors carefully observed and considered all aspects that relate to international mobility. They included chapters and segments that deal with areas that perhaps fall outside the ambit of fiscal legislation but which are inextricably linked to an international individual's tax obligations. This includes chapters on work permits, expatriate remuneration methodology and exchange control, which also informs the topic of financial emigration. These chapters will be invaluable in any cross-border tax planning exercise.

The full list of 15 chapters is as follows:

1. Overview of the South African tax systemt
2. Residency
3. Source
4. Allowances, advances, reimbursements, employee relocation, equity instruments, repayable amounts and home office expenses
5. Fringe benefits
6. Retirement funding, lump sum payments and annuities
7. Specific exemptions
8. Specific principles on capital gains tax
9. Payment of South African tax
10. Tax administration
11. Double Tax Agreement principles and taxing rights
12. Exchange control, retirement annuity fund withdrawal and common reporting standards
13. Remuneration for international employees
14. Work visas, residency permits, passports for South Africans abroad and citizenship considerations
15. Capita selecta

WIN A COPY OF *EXPATRIATE TAX!*

To be 1 of 10 lucky readers to win a copy of the book, send your answer to the following question to editor@thesait.org.za with the subject line: expat tax.

***Q:** This publication unpacks the complexities of expatriate taxes from which perspective?*

T&Cs apply. Competition ends on 30 June 2020.

On the whole, this publication unpacks the complexities of expatriate taxes from a South African perspective in a manner that speaks to the tax specialist as well as those who wish to obtain a meaningful grasp of the law.

Judge Dennis Davis, Judge President of the Competition Appeal Court, who wrote the foreword, provided the following overview:

> *"In summary, this is a carefully considered book which not only deals with all the various tax implications of immigration/emigration but even has space for a useful chapter on work permits. It is a most welcome addition to our body of tax literature and will doubtless be essential reading for anyone advising his or her client with regard to the tax consequences of migration."*

This book will be invaluable to international taxpayers, expatriates, specialist tax advisors, tax managers, financial planners, SARS and National Treasury officials, tax lecturers and scholars of tax, human resource professionals, finance executives and managers, remuneration and reward specialists, payroll experts, attorneys, chartered accountants, estate agents and tax practitioners.

THE AUTHORS

Tax Consulting South Africa has since 2015 developed into the largest independent specialist tax practice in South Africa with over 100 professionals, servicing clients across the world from offices in Johannesburg and George. They are well versed in all South African taxes and their highly diverse team specialises in tax planning, tax compliance, SARS dispute resolution and generally just providing a more efficient and cost-effective alternative. Their client base includes some of the world's largest multi-nationals, South African corporates expanding internationally, family-owned businesses as well as high-net-worth families, executives and expatriates.

The firm attributes its growth to distinguishing its service offering from the approach of the traditional large providers. Also, they serve a niche where they deal with technically complex disputes that cannot always be managed by smaller tax, law or accounting practices. Having close relationships with many other tax practitioners also helps them better serve their clients.

The firm's clients are serviced by a multi-disciplinary team of admitted attorneys, chartered accountants, tax practitioners, remuneration and benefit specialists, emigration specialists, registered accountants, certified payroll professionals and work visa specialists. A holistic client service is critical, as tax planning and compliance cannot be done in isolation from other disciplines.

Jerry Botha and Maritza Botha are the founders, Mariana Stander leads the remuneration and benefits division, supported by Tanya Tosen and Janine O'Riley, who are deeply experienced in international remuneration, payroll and expatriate tax management. Marisa Jacobs heads up the largest work visa and residency permit provider for foreign nationals into South Africa. Claudia Apicella and Jonty Leon lead the expatriate tax team, unmatched for technical expertise and efficiency in dealing with South Africans abroad; supported by Thamsanqa Msiza, heading up compliance, and Lelanie Murphy who leads the accounting team.

The tax attorneys who deeply invested time in this LexisNexis publication are, in particular, Jean du Toit, Natasha Wilkinson, Darren Britz and Johnnie Kruger. Recognition is further given to Thomas Lobban, LLM (tax), and to the chartered accountants' invaluable input – holding their own in heated debates with the attorneys – Craig Rocher and Melani Du Toit.

SPECIAL SKILLS PERMITS: WORK VISAS FOR KEY EMPLOYEES

LESEGO MATSHEKA, lesego.matsheka@kpmg.co.za

For foreign businesses wanting to send a few of their high-end experts to South Africa, South African immigration laws can form a formidable barrier to entry. Our article outlines the process of obtaining critical skills work visas for those key employees.

In June 2014, the Department of Home Affairs published the critical skills list which outlined skills and qualifications which are deemed to be critical in South Africa. Foreign nationals who qualify are eligible to apply for the critical skills work visa. The list outlining the various occupational categories was gazetted in *Government Gazette* No. 37716 of 3 June 2014.

Both foreign nationals and local employers are still grappling with the difficulties involved in securing the relevant work visas for key employees who are required to oversee South African operations of their organisations. The question at the forefront is usually – where and how do we start the process?

What is a critical skill?

The list of critical skills is derived from the merger of the exceptional skills and quota work permits lists. The list was further advanced with the inclusion of occupations in high demand as well as the scarce skills lists collated by the Department of Higher Education and Training. The objective was to ensure that the South African Government drives and develops key national projects and programmes, such as the National Development Plan.

The critical skills list comprises classifications of educational subject matter categories and each classification is further categorised into various areas of occupation or skill.

Classifications of educational subject matter categories

- Agriculture, agricultural operations, and related sciences
- Architecture and the built environment
- Business, economics, and management studies
- Information communication and technology
- Engineering
- Health professions and related clinical sciences
- Life and earth sciences
- Professionals and associate professionals
- Trades
- Business process outsourcing
- Academics and researchers
- Postgraduates

"The list of critical skills is derived from the merger of the exceptional skills and quota work permits lists."

The various occupations and skills areas identified range from agricultural engineers/ scientists; architects; actuaries and risk assessors; cisco specialists/engineers; civil engineers; food scientists, environmental engineers; retail pharmacists; solar/space physicists and riggers to doctoral graduates (with degrees acquired abroad and in South Africa). The full gazetted critical skills list is published on the website of the Department of Home Affairs (www.dha.gov.za).

Work visa application process

Where to apply

Foreign nationals applying for work visas must submit their applications through the South African consular offices or South African missions abroad and await the outcome of their applications. In some countries, the South African consulate or mission utilises the services of Visa Facilitation Services Global (VFS Global). VFS Global is an outsourcing and technology services company that serves government and diplomatic missions with the submission of visa applications and collection of visa outcomes.

Important to note is that holders of an intra-company transfer (ICT) work visa can only apply for a change of status or conditions from outside South Africa – applications within South Africa are not permitted. This is also the case with holders of a visitor or tourist visa – they are required to apply for a change of status or conditions of their visas from outside South Africa.

Only individuals who are in possession of a long-term work visa, accompanying dependant visa or study visa are permitted to apply for a change of conditions or status within South Africa and can be issued with new visas in the country.

General information on a critical skills work visa

Critical skills work visas are issued for a maximum period of five years and are renewable within South Africa. It is not mandatory for foreign nationals to have secured employment when applying for a critical skills work visa. However, it is expected that employment is secured within 12 months of issuance of the work visa. Once employment has been secured, an application for an extension can be submitted to the Department of Home Affairs for the remaining four years in South Africa.

An applicant is required to meet all the prescribed and mandatory requirements for a critical skills work visa. This includes providing a medical certificate and radiological report as well as police clearance certificates from all countries where the applicant has resided for longer than 12 months. The documentation should not be older than six months upon submission of the work visa application.

Applicants who qualify to apply for a critical skills work visa are required to obtain a certificate of evaluation of their foreign qualifications by the South African Qualifications Authority (SAQA). They are required to submit their final university degree awards, including the subject transcripts for SAQA to conduct a full evaluation of the foreign qualifications. The process may take approximately one-and-a-half months to be completed. However, this is dependent on the verification process with the respective foreign tertiary institutions. The evaluation by SAQA will assist with identifying the appropriate educational classification under the critical skills list as well as the relevant professional bodies, councils or boards recognised by SAQA. It is therefore imperative to obtain the SAQA evaluation certificate prior to applying for membership registrations, as it may also be required by the professional bodies.

"The Department of Home Affairs also requires applicants of critical skills work visas to obtain professional membership registrations with accredited professional bodies, councils or boards which are recognised by SAQA."

The Department of Home Affairs also requires applicants for critical skills work visas to obtain professional membership registrations with accredited professional bodies, councils or boards which are recognised by SAQA. Although some professional bodies may take as long as three to six months to finalise membership registrations, the Department of Home Affairs will accept proof of application for registration. It is important to note that upon adjudication of the work visa application, the director-general may grant the work visa for a period of 12 months, with visa conditions. The conditions would include finalising of the membership registration with the relevant professional body.

Employers play a vital part in the critical skills work visa process and they need to provide a prospective employee with the necessary support for their work visa application. When an employer offers employment to a foreign national who qualifies under the critical skills categories, the Department of Home Affairs will require a letter of undertaking accepting the costs related to his or her deportation and that of his or her dependent family members. Furthermore, the employer must undertake to ensure that the passport of his or her employee will remain valid at all times for the duration of his or her employment and ensure compliance with the South African Immigration Act.

Where there is no employer, the applicant is required to provide proof of sufficient financial means to the value of a minimum of R3 000 in the form of three months' bank statements and a written undertaking by the applicant to ensure that his or her passport be valid at all times for the duration of his or her temporary visa.

The process of the critical skills work visa does not require foreign nationals to obtain a certificate of recommendation from the Department of Labour to secure employment. We have encountered situations where some South African consular offices abroad have requested applicants to include a certificate of

recommendation, to determine whether the local market was tested for any suitable South African citizens or permanent residents who can occupy the position. This is only applicable for general work visa applications.

Foreign nationals who have been issued with a critical skills work visa are eligible to immediately apply for a South African permanent residence permit. However, the individual needs to be in possession of a permanent offer of employment. Furthermore, those who are still pursuing their studies do not need to apply for a study visa nor request an additional endorsement to study part-time in South Africa.

Processing time

The processing of critical skills work visa applications is usually prioritised – taking from four to eight weeks or less in South Africa with the Department of Home Affairs and abroad with the South African consular offices and high commissions.

In conclusion, foreign nationals who wish to apply for a critical skills work visa need to ensure their occupational or skills categories are listed in the gazetted critical skills list. They also need to allocate sufficient time to collate the documents for the work visa application and to await the outcome of the application prior to commencing employment with a prospective employer in South Africa.

TAX IMPLICATIONS OF LONG-TERM SECONDMENTS

30 minutes CPD

▶ **CECELIA MADDEN**, cecelia.madden@kpmg.co.za & **ZAAHID VALLY**, zaahid.vally@kpmg.co.za

Foreigners seconded to South Africa have unique additional lifestyle expenses. They need a temporary home, car, additional travel and furniture. What is the tax impact of covering these additional needs?

Multinational corporations wishing to second employees from a developed country to a less developed country sometimes struggle to convince employees with the appropriate skills to take up a long-term secondment. The company will therefore need to provide secondees with a compensation package which is attractive and will ensure that secondees are able to enjoy more or less the same standard of living while on secondment as they were accustomed to in their home country.

This can be extremely costly as the compensation package will generally include a range of benefits to support the secondee during secondment. A component of this is providing tax assistance to the secondee who now needs to manage tax affairs in two or more countries. Secondees may experience problems with cash flow and double taxation as a result of different tax regimes in the host and home countries. These may include:

- The host country 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 benefits (e.g., home country pension fund contributions).
- While on assignment secondees receive taxable compensation that they would not otherwise have received. Consequently, they have more tax to pay than they would have paid had they remained at home.

The South African tax system

The South African tax system is based on the principle of residency, and an individual's tax residence status will determine what portion (if any) of their income is subject to tax in South Africa. Tax residents are subject to tax on their worldwide income and capital gains, while non-tax residents are only subject to tax on income from a South African source and limited capital gains.

In relation to natural persons, section 1 of the Income Tax Act defines a resident for South African tax purposes as someone who is either "ordinarily resident" in South Africa or physically present in South Africa for a specific number of days over six tax years.

A person who is deemed to be exclusively resident in another country for purposes of the application of a double taxation agreement is excluded from this definition.

Source of income

A non-resident is only subject to tax in South Africa on income derived from a source within South Africa.

The term "source" is not defined in the Act. However, it is an established principle of our law that the source of employment income is the place where the services are rendered, irrespective of where or by whom an individual is paid.

In *CIR v Lever Brothers & Unilever Ltd, 1946 AD 441* it was held that the originating cause of the income is the rendering of the services, which is the quid pro quo in respect of which the income is received. The location of the source is therefore the place where the work is performed.

Secondees sometimes have regional responsibilities and must perform certain duties in other countries while on secondment in South Africa. To prevent double taxation, secondees' remuneration will need to be apportioned to exclude, from South African taxable income, the portion that relates to services rendered outside South Africa. However, if the services rendered outside South Africa by the secondee are regarded as incidental, then the source of the income will be fully South African.

SARS accepts that the correct method to apportion income for services rendered, both in South Africa and abroad, is to consider the number of workdays in each jurisdiction. "Workdays" do not include weekends, public holidays or leave days.

Benefits typically provided to secondees

In addition to providing various cash allowances, including hardship and cost-of-living allowances to secondees to compensate them for different cultural, social, physical or other living conditions in a host country, the employer will generally also provide the benefits discussed below.

Tax equalisation and tax protection

In order to remove the need for the secondee to consider the tax consequences of the secondment when deciding whether or not to accept the assignment, the employer may decide to tax equalise or tax protect the secondee. The purpose of tax equalisation or tax protection is to ensure that a secondee undertaking an international assignment is not in a better or worse financial position as a result of the assignment.

What is tax equalisation?

Tax equalisation ensures that an assignee bears approximately the same tax liability that they would have paid had they remained at home. The secondee remains liable for the tax they would have paid had they remained at home and not taken up the secondment. The secondee's pay is reduced by a notional amount equivalent to the home country tax liability, more commonly known as hypothetical tax. The employer then assumes responsibility for paying any home and host country tax liabilities that exceed the secondee's hypothetical home country tax liability, should these liabilities arise.

What is tax protection?

Where a tax protection policy is implemented, the secondee's hypothetical home country tax liability is calculated. However, the pay is not reduced by this amount. The secondee remains liable for paying his or her home and host country tax liabilities. However, if the secondee's total tax liability exceeds his or her hypothetical home country tax liability, the employer will reimburse the difference to the secondee.

Payment of employee's debt

Under a tax equalisation policy, the secondee's home and host country tax liabilities are paid by the employer. Where an employer pays a secondee's tax liability a taxable fringe benefit arises in the secondee's hands. The secondee's remuneration must therefore be grossed up to account for the tax-on-tax effect. This applies equally to any amounts reimbursed to a secondee under a tax protection policy.

Professional tax services paid by the employer

Since a secondee's tax affairs can be fairly complex and the employer may have a vested interest in ensuring that the secondee's tax liability is correctly calculated, tax compliance assistance is often provided to secondees. These services are generally outsourced to a service provider.

- Historically, South African employers and tax practitioners have been of the view that the fees incurred in providing tax services to secondees were not wholly incurred for private or domestic purposes. It was the view of most employers and tax practitioners that expatriate tax compliance services would not constitute a free or cheap service as defined in paragraph 2(e) of the Seventh Schedule to the Income Tax Act.

  While there was a private element to these services, in many cases, the main reason for providing tax compliance services to secondees was to ensure that any tax for which the employer was liable under a tax equalisation or tax protection policy was correctly calculated. Furthermore, the employer wished to ensure that its secondees were tax compliant in the country where they were working, as any failure to comply with the host country's tax regime could pose a reputational risk to the employer.

  It is also worth noting that the tax treatment of professional tax service fees as a benefit in terms of paragraph 2(e) of the Seventh Schedule was not consistently enforced by SARS and the position was therefore unclear.

  Notwithstanding, in *BMW South Africa (Pty) Ltd v The Commissioner for the South African Revenue Service (1156/2018) [2019] ZASCA 107; 2020 (1) SA 484 (SCA) (6 September 2019)*, the Supreme Court of Appeal held that tax services rendered by a tax service provider at the expense of an employer constituted a taxable benefit in the hands of the employee.

  This has now placed an additional financial burden on employers, many of whom have agreed to pay the tax on this benefit on behalf of their secondees.

School fees paid by the employer

In order not to disrupt their education and to ease their transition, a secondee's children may need to attend a school which has a curriculum similar to that in their home country. The employer may pay the necessary school fees, giving rise to a taxable benefit in the secondee's hands. The value of the benefit is the amount paid by the employer.

"Where secondees are no longer tax resident in their home country and have not established tax residence in South Africa, double taxation may occur as in some countries it may not be possible to claim a refund of the taxes withheld."

Home-leave flights
The employer may provide the secondee and his family with a certain number of flights per year for home-leave purposes. Where this is the case, a taxable benefit will arise in the secondee's hands equal to the cost to the employer of the international flights.

Residential accommodation
Employers generally provide the use of accommodation, which is a taxable benefit.

A concession is provided (for inbound secondees) under paragraph 9(7A) and (7B) of the Seventh Schedule to the Income Tax Act (subject to certain conditions): no taxable value is placed on the use of accommodation provided by the employer to the secondee for a period not exceeding two years from the date of arrival in South Africa to commence employment. The tax-free amount is, however, limited to R25 000 multiplied by the number of months during which the accommodation was provided.

Security costs
Secondees coming to South Africa are generally aware of the high crime rate in South Africa and will often insist that their employer provides adequate home security such as an armed response security service. The cost of the security service is a taxable benefit in the hands of the secondee.

Motor vehicles
The employer will generally provide a secondee with the use of a company vehicle during the secondment period. A second company vehicle may also be provided to the secondee's spouse. The use of each company vehicle constitutes a taxable benefit in the hands of the secondee.

Relocation expenses
Historically, SARS allowed employers to pay a tax-free relocation allowance of up to one month's basic salary to an employee to cover settling-in costs, without the employee having to prove actual expenditure incurred. From 1 March 2016, the cost of certain settling-in expenses may be reimbursed by the employer to the employee if the employee provides proof of the relocation expenditure incurred. If an employer reimburses actual expenditure incurred, or pays the supplier directly, an exemption may still apply in respect of transportation costs, certain settling-in costs and temporary accommodation.

Mechanisms against double taxation

Non-tax residents are precluded from claiming a rebate (foreign tax credit) in terms of section *6quat* of the Income Tax Act, against their South African tax liabilities, as the country of residence is generally required to give up its right to tax income, to the country of source. To prevent double taxation, non-resident secondees therefore need to claim relief from tax in their country of residence.

Difficulties do sometimes arise where secondees remain on their home country payroll and there is a requirement to withhold tax via the payroll in respect of South African sourced income.

Where secondees are no longer tax resident in their home country and have not established tax residence in South Africa, double taxation may occur as in some countries it may not be possible to claim a refund of the taxes withheld. This aspect should be considered in the assignment planning process.

A secondee who has remained tax resident in their home country will need to claim a foreign tax credit against the home country tax liability for taxes paid in South Africa – on South African sourced income included in the home country taxable income.

WHEN IS A WORKING VISITOR SUBJECT TO SA TAX?

30 minutes CPD

▶ **DONÉ HOWELL,** dhowell@bdo.co.za

Who gets to tax foreign workers who visit South Africa for a few days or weeks? Does it matter who pays for this local work? Our article takes a look at some of the issues.

The point of departure, literally, in understanding who is liable for South African normal tax should always be a review of the concept of residence.

Therefore, whether one is considering the normal tax implications for a long-term or short-term inbound foreign worker or a South African resident outbound worker, the definition of "resident" as found in section 1 of the Income Tax Act should be considered closely.

For the sake of brevity we assume that a working visitor, being on a short-term assignment and with the intention to return to his or her country of residence after completing the assignment, does not qualify as ordinarily resident in South Africa nor does he or she meet the requirements of the physical presence test. Our working visitor will therefore not be regarded as a resident of South Africa for normal tax purposes. As a non-resident he or she will be liable to normal tax on income sourced in South Africa, subject to certain exemptions contained in the Income Tax Act and the provisions of a double taxation agreement.

For taxation purposes, how long is a temporary visit?

The Act does not define what constitutes a temporary visit to South Africa. Colloquially the tax industry understands such to imply a period of less than 183 days (not more than six months) in any consecutive 12-month period.

South Africa does not have *de minimis* rules relating to how long a person must be in South Africa physically rendering such services before he or she is liable for normal tax. Whether in fact the person is subject to normal tax would depend on the provisions of the double taxation agreement as well as the quantum of employment income which the person earns for services rendered in South Africa, i.e., whether it exceeds the tax threshold.

Treaty relief for the employed working visitor

Generally, South Africa's double taxation agreements follow the OECD Model Tax Convention.

Article 15 of the OECD Tax Treaty deals with income from employment and essentially provides that employment income earned by a resident of a contracting state should only be taxed in the state of his or her residence (home country), unless the employment is exercised or rendered in another contracting state (host country).

The administrative burden and compliance complexities of taxing short-term assignments in the host country could outweigh the commercial reasoning for the assignment. In order to eliminate taxation in such cases, a proviso to paragraph 1 of Article 15 allows that the host country will lose its right to tax such employment income where all three conditions below are met, namely:

1. The employee is physically present in the host country for a period or periods not exceeding 183 days in any 12-month period
2. The employment income is paid by or on behalf of an employer who is not a resident of the host country
3. The employment income is not borne by a permanent establishment (as defined in Article 5 of the OECD Tax Treaty) which the employer has in the host country

With regard to the second condition, the OECD has not provided sufficient clarity to the term "employer". Many countries interpret the term to mean the contractual employer while others, including South Africa, interpret employer to mean the entity paying the remuneration or incurring the cost of the remuneration (economic employer). Where there is a recharge of employment costs to the South African entity SARS, having adopted the economic employer approach, will regard such condition to have not been met. This results in employment income earned by even short-term assignees being liable to normal tax in South Africa.

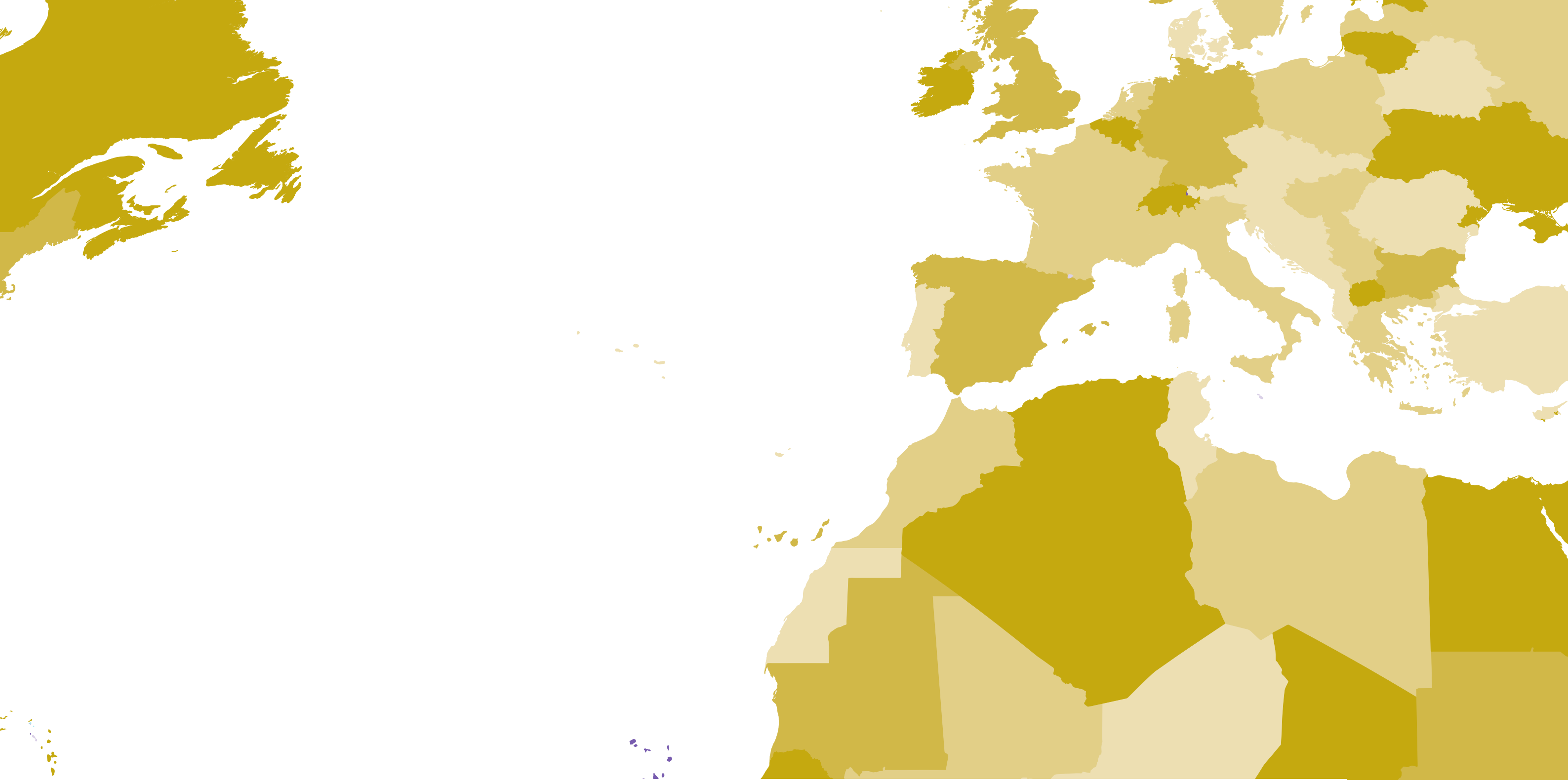
When it issued Binding Private Ruling 085 in 2010 SARS made it clear that it adopted the economic employer approach as compared to the contractual employer. This shook up the long-held view that treaty relief was available to short-term assignees while rendering services in South Africa, or for that matter globally.

Other factors to consider

Determining the taxation of any inbound working visitor to South Africa cannot be done in isolation and requires inter alia consideration to and understanding of visa and work permits granted by the respective government departments. The visa applied for should speak to the type of work to be performed or the services to be rendered and the likely duration of the person's stay for work purposes. The correct visa should be applied for before entering South Africa and could range from a business visa, three-month work visa, inter-company transfer work visa to a visitor's visa.

A further consideration is whether the work performed is incidental to the main services to be rendered. In *CIR v Nell* (24 SATC 261), the court held in deciding whether an apportionment is required of the employment income earned where services were rendered in two countries, *"where work done outside a country is purely incidental to and or preparatory to the rendition of a service within that country, the real source is located within that country. In such a case…does not mean that there is a separate or distinct source in respect of that work or that there must be an allocation of part of the income to it."*

The employment contract should specify the required services and the location where they are to be performed. A determination can then be made whether to exclude the employment income from normal tax where such services rendered in South Africa qualify as incidental.



Consultants, sportspersons and entertainers

In the scenario where a person is not an employee of a foreign employer but trades independently and such person comes to South African to render a service, the Income Tax Act provides that such person does not qualify to be carrying on a trade independently. Amounts paid to such persons, accordingly, fall within the definition of remuneration. The OECD Tax Treaty covers the taxing rights for an independent consultant who trades independently from an employer under Article 5 'Business Profits'.

The taxation of foreign entertainers and sportspersons is governed by sections 47A to 47K of the Income Tax Act. These sections provide for a withholding tax of 15% in respect of all payments made to such persons. This is considered to be a final tax and therefore obviates the need to render a personal income tax return to SARS. There are, however, declarations which both the entertainer or sportsperson and the South African resident organiser (if applicable) is required to make to SARS.

The rate of 15% is relatively high, especially where the entertainer or sportsperson has incurred expenses in the production of such income, because the fixed rate is based on gross income and does not allow for the offset of business expenses.

Therefore, it is important to note that the South African statutory provisions may be subject to double taxation agreements, which in many cases allow for a lower rate to be applied.

Who pays for the work: foreign employer or SA client?

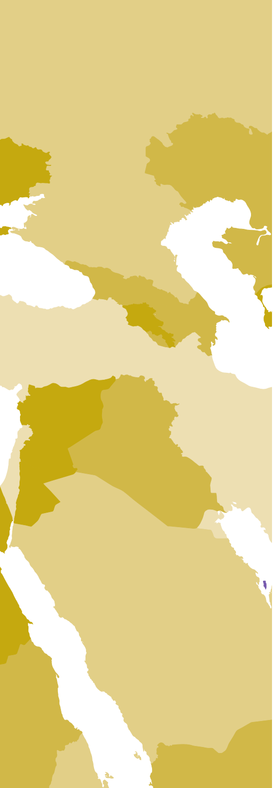
It is an established principle that the source of employment income is the place where services are actually rendered. To the extent that a working visitor is obliged to render services in South Africa any employment income received by such person should therefore, subject to the provisions of a double taxation agreement, be subject to normal tax.

It is important to note, however, that this principle does not apply to compensation paid to directors of companies for attending board meetings, whether in the capacity of non-executive director or director. The source of these fees is considered to be the location of the main office of the company.

Whether the normal tax is to be settled as employees' tax or provisional tax is a question of whether the working visitor is paid by a foreign employer or a South African employer.

Where the employer is not a South African resident for tax purposes, employees' tax needs to be withheld by an agent who is a South African resident and who has the authority to pay the remuneration of the working visitor (as representative employer). Should the foreign employer not have a qualifying representative employer in South Africa, the working visitor is obliged to register for and settle his or her liabilities for normal tax as provisional tax payments.

In many arrangements it is agreed that the South African company to whom the services are to be rendered will, while the working visitor is on assignment, provide or pay for certain services such as accommodation and the use of a company vehicle for commuting. These constitute taxable benefits and are subject



to normal tax. The South African company, now considered to be the employer in respect of the payment or granting of such taxable benefits, is obliged to withhold normal tax in the form of employees' tax.

If the working visitor is subject to normal tax, he or she is obliged to register with SARS as a taxpayer. Subject to the recently introduced conditions to exempt qualifying taxpayers from the requirement, the visitor may be required to render an annual income tax return to SARS, disclosing his or her South African remuneration and concomitant employees' tax withheld.

No simple matter

With each country vying for a piece of the global assignee's tax pie, care should be taken in considering the various factors which each contribute to the ultimate decision of the taxation of such persons.

Each case should be considered on its own facts and circumstances, taking into account the employment contract, the assignment agreement between the respective companies, the duration of the working stay in the foreign country, the visa applied for and which company ultimately bears the cost of such person's remuneration.

Not a simple matter at all and with penal and criminal sanction realities for the working visitor and the employer it makes for good practice to seek advice from a registered tax professional.

"With each country vying for a piece of the global assignee's tax pie, care should be taken in considering the various factors which each contribute to the ultimate decision of the taxation of such persons."

WORK VISAS ACROSS AFRICA

TARISSA WARELEY, tarissa@xpatweb.com

Our article provides a glimpse into the intricacies of obtaining the correct visas and permits for highly skilled mobile workers in Africa, getting positive results and supporting tax outcomes.

The work visa application may be seen as a precursor to getting an expatriate into a country but, in reality, the work permit application can only be correctly done after the tax consultation stage. This explains why tax advisors all over Africa are our clients and equally we are the clients of so many tax practices. There is a symbiotic relationship: we need tax sign-off before we can advise our clients on the correct permit category. By the same token, tax practices require work permit specialists to ensure that their planning and compliance strategies are correctly executed and not contradicted by the permit application.

Permits and tax advice

There are plenty of examples of "schoolboy errors" all over Africa, where an incorrect permit application caused adverse consequences in fiscal areas. Two examples are sketched below.

Short-term work visa

A South African section 11(2) visa is issued where a foreigner comes to South Africa for a short period and the purpose of the visit is "work" as opposed to only "business". We have been called in a number of times where foreigners have entered South Africa on the pretence of "business". When they were caught behind a desk in South Africa, they faced being arrested and deported.

These 11(2) visas take only 10 days to obtain and are issued for three months, with a possible three-month extension after that. Who should be the employer on this visa? Where the foreign employer is noted for issuing purposes, a "permanent establishment" risk is created from a tax perspective. This is especially true where the three months are extended to six months or where a number of these short-term expatriates enter South Africa. Where a South African resident employer, or perhaps a subsidiary or local agent, obtains this permit does the expatriate qualify for the dependent personal services relief in article 15(2) of most double tax agreements?

Permanent residency

There are mechanisms to fast-track South African "permanent residency" status, especially where the expatriate is well qualified or has an investment to make. This is a sought-after commodity for many expatriates, as it provides the expatriate and their family with long-term certainty on their right to reside. That being said, what are the tax residency and exchange control implications of going on record as having an intention to stay permanently and indefinitely in South Africa?

How welcome are expatriates in South Africa and across Africa?

There are plenty of horror stories, but the day-to-day experience is something completely different. Where a correct permit application process is followed, using the correct channels and being proactive in fulfilling the requirements, a positive

outcome is the norm. This position applies not only to South Africa, but across Africa. The consensus is that expatriates who bring special skills and investments are welcome, whilst those who pose any threat to local employment can generally expect to be met with resistance.

This means advice on the category of the permit and on formalities must be done on a first-time correct basis. A good work permit strategy is also to always have a "plan B". In other words, if anything goes inadvertently wrong your back-up strategy must be in place.

We do not expect this to change post COVID-19, as companies will be under renewed pressures and that necessarily requires those critical skills. Governments will also be under pressure to compete for investments, including various African infrastructure projects, health services and agriculture. Making expatriate processes unnecessarily difficult is therefore simply counter-productive.

Free-trade agreements

As novel as the methodology may be, and despite considerable talk and plans around these agreements and the visa-free movement of individuals, the actual implementation is not anticipated soon. South Africa, as an example, desperately needs farm workers to support certain commercial farming sectors. We assist various commercial farmers to obtain corporate visas to allow the employment of farm labourers. This is a sector that will significantly benefit from a free-trade arrangement, including from a labour perspective.

Work visa challenges and strategies

Challenges and strategies around work visas differ from one location in Africa to the next. It often depends on whether the underlying law is based on English, French or Portuguese legal principles, as this directly impacts the level of administration, legal interpretation and complexities of the process. The following are generally good housekeeping rules:

- Identify the correct category of permit upfront
- Comply with all documentation requirements to avoid delays
- Engage upfront with authorities, especially where there are complexities

> *"Where a correct permit application process is followed, using the correct channels and being proactive in fulfilling the requirements, a positive outcome is the norm."*

Work permit drivers and tax outcomes

The direct link between work permits and tax outcomes is the physical performance of employment services by a natural person from one jurisdiction in another jurisdiction. In accordance with OECD principles, this physical activity in a jurisdiction is the prerequisite for various taxing rights, for example, the taxation of employment income. It is also one of the factors in potentially creating a permanent establishment, although we must caution it is not a prerequisite nor the only factor from a corporate tax perspective. The physical rendering of an employee's services in a location to a non-resident employer can also trigger various other fiscal consequences. An example is the creation of a "branch" or, more technically put, a fixed place of business. This requires registration under the Companies Act, the appointment of a public officer, possible VAT registration and will have implications for employees' taxes.

Most areas of tax may be impacted by an employee working on a permit in another country. Of course, this is where tax advice becomes important and the competent advisor will also consider whether a tax consequence for the home country or seconding entity is, indeed, created in the host country. This speaks to the manner in which effect is generally given to the secondment or assignment.

We pause to note that work permits are generally for a fixed period and it is generally prudent, at least from a labour law and work permit law perspective, to align the employment term with the work visa term. There is South African case law to the effect that an invalid work permit does not automatically give the employer the right to terminate employment.

The key decision to make is normally whether the employee remains employed by the home country and is physically performing services for the home country, or whether the employee is truly seconded to physically perform employment services for the host country, for its economic benefits and at its cost. The work visa must be aligned to the group structure and validates the tax treatment adopted. As the onus of proof is on the taxpayer, a valid work visa provides a compelling objective factor which must be considered in understanding the parties' subjective intention.

Gateway to Africa

We are increasingly assisting South African tax, law and accounting firms advising into Africa, even where there is no apparent South African link. The reason appears to be that most large projects into sub-Saharan Africa have some South African link, whether financial, logistical or otherwise. We note below a brief synopsis per key African territory where we often assist with permitting matters.

Eastern Africa

Immigration regulations in Eastern African countries have rules that are different to other African territories. Some countries implement regulatory measures to separate "residency permits" from "work permits", whilst others have a "single permit application" for work purposes, as opposed to a layered approach.

Kenya

The work visa law adopts a "singe permit approach", which makes one permit application sufficient for work compliance. The immigration authorities are stringent on the requirements for work permit applications, due to high unemployment. Unlike many other services provided by the Kenyan government, immigration services are less straightforward. Generally, the immigration authorities are not reachable and, as such, delays are experienced throughout the process of applications for matters such as work permits, special passes, alien IDs and driver's licence exchanges. These challenges restrict employers from bringing foreign skills into Kenya and can only be overcome with a strong on-the-ground presence.

Western Africa

Western African countries benefit from freedom of movement, particularly amongst members of the Economic Community of African States (ECOWAS). ECOWAS' first migration protocol implemented the right for citizens of its member states to enter and reside and establish economic activities in the territory of other member states.

Ghana

Ghana is a member state of ECOWAS and has implemented various immigration policies, many of those to promote the investment of not only citizens of ECOWAS member states but also global investment through facilitating the immigration processes in such instances. For example, a standard work permit in Ghana is an authorisation granted to an employer or employee to engage in lawful and gainful employment, which can be seen to greatly favour local skills. Expatriate quotas, on the other hand, once granted, are valid for an indefinite period, that is, for as long as the investors require foreign skills in Ghana to facilitate their business operations. These expatriate quotas are, however, limited to the investor's initial capital investment into the Ghanaian economy. Streamlined immigration processes coupled with appropriate tax advice contribute towards successful business operations in Ghana for employers.

Central Africa

The countries in Central Africa have a strong French influence and a common occurrence is to separate the permits between the following:

- One that allows a person to reside in the relevant jurisdiction
- Another permit to work
- Sometimes an additional visa to allow for the entry into and exit from the jurisdiction

Democratic Republic of Congo (DRC)

An example of a country with the above multiple permits requirement is the DRC. The main challenge experienced in this jurisdiction is the layered processes and the submission of each permit application to a different government department. For example, expatriates must obtain their worker's cards from the Commission Nationale pour l'Emploi des Étrangers, and their work permits or visa d'établissement de travail (VET) from the migration authorities: the Direction Générale de Migration. The expatriate must also obtain an exit and entry visa from the Direction Générale de Migration, as the work permit does not allow for exit from the jurisdiction.

Employers are encouraged to ensure they allocate an appropriate lead time to safeguard their key personnel arriving in-country in the appropriate timeframe required. Accurate record keeping is necessary to ensure the validity period of the various permits and visas are up to date and renewed prior to expiry.

Southern Africa

Countries in Southern Africa share some similarities but also slight differences on how immigration regulations are viewed and in turn implemented. This can easily be identified through a comparison of Mozambique and South Africa, two neighbouring countries that form part of the Southern African Development Community.

Mozambique

Employers should be aware that permit applications to work on a long-term basis in Mozambique are document intensive and bureaucratic. The number of foreign nationals that employers can apply for depends on the number of Mozambican employees. Employers often experience challenges to employ enough Mozambicans to allow for an additional quota for their foreign nationals. However, the immigration regulations have made provisions for "outside quota" applications for skilled and highly qualified foreign nationals and, as such, employers can ensure their qualified and skilled professionals can obtain the appropriate work permits required.

South Africa

The South African immigration system is geared towards attracting and retaining skilled migrants and foreign investors. This approach makes it difficult for unskilled and lengthy for semi-skilled foreign nationals. One of the cornerstones of the South Africa immigration system is skills transfer to South Africans and permanent residents. South Africa is seen by many professionals in Africa as the number one destination for opportunities. While South Africa has a high unemployment rate, the government has accepted the need to attract critically skilled foreign nationals to boost the economy, develop the country and transfer skills to locals. This has proven to also create employment opportunities. The publication of the Critical Skills list gives expression to the calibre of foreign nationals that are lured to South Africa. Any foreign national who squarely qualifies for a Critical Skills Work Visa would have a seamless process to obtain a visa.

In conclusion, the immigration authorities across Africa are making efforts to achieve economic growth through migration policies allowing freedom of movement for business purposes, streamlined processes for investors and encouraging critical skills into their local work

OFFSHORE ENDOWMENT POLICIES: The estate planning and tax benefits

15 minutes CPD

▶ **HARRY JOFFE,** harryj@discovery.co.za

Our article looks at the tax aspects of investing in an offshore endowment policy and weighs up the advantages of using a local versus a foreign insurer.

More and more South Africans are using their investment allowances to invest offshore. To this end they use either the R1 million single discretionary allowance or the R10 million allowance that requires a tax clearance certificate allowance, or both. This article will attempt to identify some of the advantages of using an offshore endowment policy with a South African insurer.

Ability to nominate a beneficiary

An endowment policy with a life assured allows the owner to nominate a beneficiary. This is the person to whom the proceeds will be paid on death of the life assured. In the offshore world this is a major advantage as it helps to avoid the problem of probate. Probate is the process whereby a foreign estate has to be wound up, and can prove particularly problematic.

Let us look at an example where John dies in South Africa. He has two offshore investments not in an endowment wrapper: One is in the UK and one in Jersey. John's local executor has to engage with two offshore executors to help wind up the foreign portion of the estate. This can be time consuming, especially given the fact that the South African Master requires an original will, and so do the offshore authorities. It can also be expensive. In addition, if the offshore amounts are small, it will be difficult to find anyone offshore willing to do the work. Because the amount they will be able to charge is limited, it will not be worth their time.

If, however, the two offshore investments are in an endowment wrapper, then the nominated beneficiary is simply paid. There is no need to go through the foreign probate or winding-up process. This is obviously much quicker and cheaper. It should also be noted that most South African insurers have very creative products that allow the proceeds, or the actual policy itself, to move to nominated beneficiaries without having to pass through the estate. This applies in the case of both a beneficiary for proceeds (where the life assured dies) and a beneficiary for ownership (where the policy owner, who is not the life assured, dies). The ability to nominate a beneficiary also ensures that the proceeds will not be subject to executor's fees. Estate duty will, however, not be avoided as the policy is still an asset in the estate, even though the executor is not handling the proceeds.

Estate duty

Although, as discussed above, the policy will be estate dutiable in the deceased South African estate, at least there will not be any estate duty offshore because all these policies are registered in tax centres.

Let us look at two scenarios where John buys US mutual funds.

Scenario 1

John buys mutual funds directly in the US through a fund there. When he dies, the investment is estate dutiable in the US because of situs tax. For non-US residents the estate duty exemption is only $60 000 and the actual duty can be as high as 40%.

Scenario 2

John buys the same mutual funds through an endowment wrapper issued by a South African insurer via an offshore financial centre. There is no estate duty in the US. There is also no duty in the offshore financial centre. The only estate duty is in South Africa, where the top rate of 25% is lower than that of the US. If John's spouse is the beneficiary, there is no estate duty at all in South Africa. Owning offshore mutual funds through an endowment wrapper avoids the situs tax problem for estate duty, particularly in the US.

Tax benefits

A foreign endowment with a South African insurer is taxed in terms of the five fund system. That means the endowment is subject to portfolio tax. The benefits of this to the high-net-worth investor is that capital gains are taxed at the insurer's rate of 12%, and not the individual's potentially higher rate of 18%. With the large sums involved in using a tax clearance certificate allowance, the R40 000 annual capital gains rebate is not usually that relevant. Income gains are taxed at the insurer's rate of 30% and not the individual's potentially higher rate of 45%. Again, with the large sums involved, the interest rebate of R23 800 is not that relevant.

More importantly, using an offshore endowment policy with a South African insurer there is no further tax to be paid by the investor because all the tax is paid by the insurer in its portfolio. This makes the tax return much simpler. Assume, for example, John invests his R10 million tax clearance certificate allowance offshore in 10 different mutual funds, with various different providers. At the end of the tax year he will need to report to SARS all the foreign dividends received, foreign interest earned, as well as any capital gains made. Any tax statements he receives from the offshore providers will be in a foreign currency and will need to be converted to rands for reporting purposes. His tax return will not be simple!

However, if he simply bought an offshore endowment with a South African insurer, even with 10 mutual funds inside that wrapper, his tax return will be much simpler as all the tax has already been paid by the insurer in the portfolio. He therefore does not need to worry about gathering tax statements and converting everything to rands.

Finally, if the investor switches units, it triggers capital gains tax across both types of wrapper: unit trust and endowment. Let us assume it is a straight switch and the investor does not receive actual cash. The investor in a mutual fund might have a cash flow problem at the end of the tax year when he or she has to pay CGT. In an endowment CGT must still be paid – but by the insurer. The insurer takes the money out of the investor's portfolio and the investor does not suffer any cash flow problem.

Using a non-South African insurer

Seeing as South African insurers all pay portfolio tax in terms of the five fund system as discussed above, would it not make sense to buy a policy through a non-South African insurer who does not pay portfolio tax? Although this might sound attractive, readers should beware. Although SARS' Binding Private Ruling 179 of 2013 has now expired, it is a clear indication of SARS' thinking and how they would treat such an offshore, non-SA endowment. The key quotes from this ruling are as follows:

"The ruling made in connection with the proposed transaction is as follows:

- *The investment assets are held on behalf of the Applicant.*
- *All amounts received or accrued in respect of the investments shall accrue to the Applicant.*
- *In the alternative, the provisions of section 7(1) will be applicable, on the basis that the amounts remain due and payable to the Applicant, whether the amounts will be credited in account or accumulated or capitalised or otherwise dealt with in the Applicant's name or on the Applicant's behalf.*
- *Any realisation or liquidation of the investment assets as a result of an election made by the Applicant upon the surrender of the policy will constitute a disposal of those assets on behalf of the Applicant in respect of which paragraph 35 will apply.*
- *In the event that the Applicant receives the 1% life cover payment, this pay-out will constitute proceeds and be taken into account when calculating a capital gain or loss for the Applicant. The provisions of paragraphs 40 and 55 will not be applicable."*

Some readers may disagree with the ruling, as it basically treats the offshore endowment as a unit trust and looks through it. Others would argue that SARS is correct: Why should a foreign endowment, not registered under the Long-Term Insurance Act or Income Tax Act, receive the tax benefits that a South African endowment does? The issue is still not clearly settled and a court might find differently. However, given SARS' view in the BPR, readers should be aware of the potential risk attached to these non-SA registered foreign endowment policies.

One size does not fit all

For an investor committing a large lump sum to an offshore investment, an offshore endowment wrapper with a South African insurer can offer estate planning and tax advantages. However, make sure to check the costs on such an investment and also take professional tax advice. Each case is dependent on its own facts and there should not be a "one-size-fits-all" approach.

> *"For an investor committing a large lump sum to an offshore investment, an offshore endowment wrapper with a South African insurer can offer estate planning and tax advantages."*

BE AWARE: No investment is perfect, and some offshore endowments have expensive cost structures. Before committing to purchase, readers are advised to investigate fully and in detail these cost structures as well as any penalties for early cashing in.

SOUTH AFRICAN EXCHANGE CONTROL

Has the magic moment arrived?

30 minu es CPD

► **LOUIS VENTER,** louis@wealthsuccession.co.za

The Budget Speech and documents contained some extraordinary statements about exchange control. It is due to be lifted but for certain exceptional areas. Our article takes you from the beginning through to what seems to be the end of this saga.

Circular 2/2020, published on 27 February 2020 by the Financial Surveillance Department (FinSurv) of the South African Reserve Bank, caused a ripple of excitement amongst those of us who have been working under the confines of exchange control for our entire professional lives.

The following words introduced a whole new direction in controlling capital flows and foreign currency transaction to and from South Africa:

> *"This involves a shift from the current negative bias framework to a positive bias framework where all cross-border transactions will be allowed, except for those that are subject to the capital flow management measures and/or pose a high risk in respect of illegitimate cross-border financial flows."*

On closer inspection, could this be a false new dawn? I don't think so. I think the change is irreversible and real.

1961 – The birth of exchange control

1961 saw the Baby Boomers in their full prime. It was a time of contradiction. The Russians built the Berlin Wall in that year but also sent the first man into space. On the one hand they created physical isolation for the East Germans but on the other hand they achieved the ability to see the world as a wall-less, borderless, unified planet from space.

South Africa, under then Prime Minister Hendrik Frensch Verwoerd, found itself being increasingly isolated from the world. This forced the country to withdraw into a protective financial cocoon. And from within this cocoon of self-inflicted political, cultural and commercial isolation, Government Notice R.1111 of 1 December 1961 was promulgated by the then National Party. It provided the basic legislative framework for exchange control as we know it today.

Progressive New World during the ’80s and ’90s

The new dawn that broke over the world during the 1980s and 1990s brought freedom and enlightenment to most parts of the world. The Berlin Wall came down, Russia embraced “Glasnost” and “Perestroika” and the Cold War ended. The South African National Party Government released Nelson Mandela and other freedom fighters, South Africans abolished Apartheid and held free and fair elections. The word “ubuntu” replaced the word “apartheid” in internationalised South African parlance.

In line with this progressive political and economic direction, the Exchange Control Regulations became more permissive. Yet the basic premise on which the legislative framework of exchange control was created surprisingly survived this new dawn. I honestly did not think it would see the 2000s!

Present position

Presently South Africans, including those “deemed” to be living abroad on a temporary basis, are prohibited from owning any sort of foreign assets and engaging in a foreign currency transaction unless the State approves of such ownership or transaction or creates a legislated exception to this blanket prohibition. This is the current negative bias framework. It is akin to the coronavirus lockdown that is being applied at the time of the writing of this article. You are to remain at home unless a reason has been promulgated to create the exception to leave your home. The exchange control lockdown has now been in place for almost 60 years.

“Hopefully exchange control measures will be dismantled even further to assist South Africa to participate on an equal footing in the global village.”

Future position

During his budget speech in February 2020 the Honourable Minister of Finance, Mr Tito Mboweni, rose like a phoenix from the ashes of this redundant piece of laager mentality policy. He announced that the world of the currency control prison in which South Africans have been living since the days of Dr Verwoerd will change forever.

As mentioned earlier, the current negative bias framework makes foreign currency ownership and transactions unlawful unless an exception exists in the regulations to allow for such ownership or transaction.

Let us use an example: As a South African, it is unlawful for me to own any sort of foreign currency unless I can find an exception in the regulations which allows such ownership. Natural person individuals are allowed both an annual R1 million fully discretionary allowance every year to use as they like abroad and a R10 million per year investment allowance upon receipt of a special tax clearance certificate from SARS. Individuals can only do this because an exception to the general prohibition was enacted.

Circular 2/2020 proposes a framework where any foreign currency ownership or transaction is lawful unless specifically restricted. This is what is meant by the positive bias framework and it is not a small change. It is a tectonic shift and well worth the ripple of excitement.

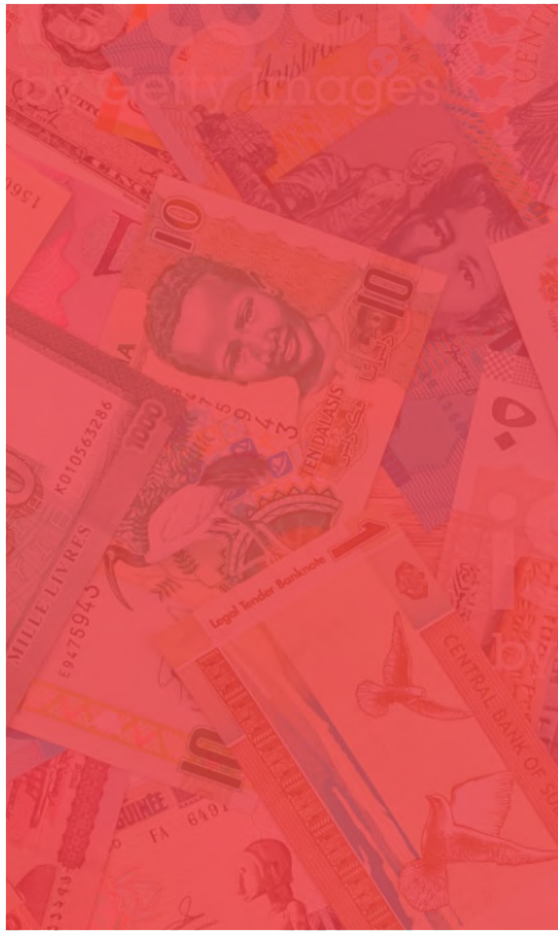
What exactly is changing and why?

What we are about to enter over the next 12 months is an environment where it might seem on the surface as if many of the rules are still unchanged. The big change is that from now on a positive act is required to create and increase control measures, rather than a positive act to ease restrictions. In the constitutional democracy in which we live, this is a massive move towards the ability to judicially test the legitimacy of exchange control measures forced upon South African citizens by their Government.

So why now? What has given rise to the change in policy by the Government? In line with the Minister's typically honest approach to matters, he admitted that the Government's hand was forced into this action. The ability to freely participate in a global world of commerce is hampered by disallowing citizens of your own country to participate freely in the world economy. This is highlighted whilst travelling the world asking for direct and indirect investment into your own country by citizens of other countries. The principle of reciprocity between nations needs to apply.

The principles contained in the OECD's Code for the Liberalisation of Capital Movements and South Africa's key role in negotiating the African free trade area simply made it impossible to persist with the current exchange control framework.

The absolute irony is that the Code was first adopted in 1961 – the same year Government Notice R.1111 was promulgated.



What are the practical implications?

Yes, in theory, we have shifted the dial massively. But in practice some things will indeed still look the same and the libertarians under us will be greatly disappointed.

If one were only to read Annexure E to the 2020 Budget Speech, one would have gotten quite excited. Reading the full document from the Reserve Bank that followed, would have dampened that joy substantially. In the end, detail matters, so let us look at a few aspects of the proposed changes expected to come into effect within the next 12 months.

Proposed exchange control changes

ENTITY	WHAT WILL CHANGE ?
INDIVIDUALS	• No approval will be needed for amounts up to R10 million per year. The R1 million travel allowance per year will stay in place, making it an R11 million free for all. • All natural persons will be treated equally. No distinction will be made between resident and emigrant anymore. • The transfer of more than R10 million per year will be allowed but will be subject to stringent verification. This requires FinSurv approval currently. • Non-residents will be able to borrow 50% of the funds needed to buy residential property from local banks. • Non-residents working in South Africa will be able to borrow money from local banks to buy residential property on the same terms as any South African person.
COMPANIES	• Invoicing and pricing will be permitted in foreign currency. Payment will have to be done in rand. • Tourist operators (on application) will be able to price, invoice and receive payment in foreign currency. • Currency hedging onshore under 12 months will be allowed. Hedging for longer than 12 months will require additional documentation to be lodged. • Non-residents will be able to freely borrow from local banks to fund direct investment in the country.
PENSION FUNDS AND INSTITUTIONAL INVESTORS	• Prudential limits will remain unchanged but are being debated. Expect some further relaxation here.
LOCAL TRUSTS	• Nothing will change.

Individuals

The long and the short for individuals is that they will be able to take out as much money as they want, subject to a bit of scrutiny in some instances. This in turn will mean that individuals will in future be able to bring money in and take money out with greater freedom. The global reporting systems and the changes in our tax legislation have enabled the South African tax authorities to still collect taxes on gains and income made on offshore investments and offshore earnings.

Situs tax in foreign countries, possible multiple probate processes in different countries and conflict of laws relating to testamentary freedom will become more and more of an issue as capital starts flowing freely. The more South Africans externalise their balance sheets, the greater the complexity that faces estate planning and tax professionals.

Exporting inheritances, funding children living abroad, travelling abroad, donating funds to relatives living abroad and investing abroad will not be subject to Reserve Bank imposed restrictions. Blocked rand accounts will become part of history lessons.

Bullion

The status quo will be retained with regards to exporting or importing actual notes and coins and other forms of bullion (like Krugerrands).

Crypto currencies

This brings us to the big excon nemeses: crypto currencies. A policy paper is in production to contain this hippy child of the monetary system. Let us see if the containment measures work better than they did in 1961.

Companies

Companies in South Africa will not be allowed to shift their primary domicile offshore except under exceptional circumstances approved by the Minister of Finance.

Companies will still be able to directly invest up to R1 billion in their businesses abroad, subject to adjudication by the authorised dealers. Amounts larger than R1 billion will simply be subject to an additional requirement of prior notification to FinSurv for verification and statistical reporting.

Loans between local companies and their offshore subsidiaries will also be very easy and hassle free.

Loop structures

Loop structures – where an offshore company or trust is set up to take up shares in a local company or buy local assets – will still be illegal. I believe this will change as well. Much privately owned capital is held in offshore trusts already. Being able to invest into South Africa from capital already offshore (even if held in trust) would be beneficial to South Africa. Let us rather welcome any direct investment into the Republic from wealth legally held by South Africans in offshore structures. What do we have to lose?

Intellectual property

The export of intellectual property to related offshore parties will still be controlled by FinSurv, but the sale of intellectual property to non-related parties will only require oversight by an authorised dealer. The authorised dealer will have to ensure that the transaction is a normal commercial transaction and that the price paid is based on the arm's length principle.

Trusts

Local trusts will still not be able to hold offshore assets. This is most probably an error in overly conservative thinking on the side of the fiscus. Restricting local trusts from owning foreign assets simply invites loop structures, as offshore trusts would be preferred to onshore trusts. Many South African families would use their local trust as a preferred vehicle to invest offshore as well. Allowing the use of a local trust to invest offshore would in many instances obviate the need to set up expensive offshore trusts, and hence obviate the need to create loop structures.

On equal footing

Hopefully exchange control measures will be dismantled even further to assist South Africa to participate on an equal footing in the global village.

Frankie Vaughan's no 1 hit in December 1961 now rings loudly in my libertarian ears and I hum along joyfully:

> *"If I were a tower of strength, I'd look you in the eye and here's what I'd say: I don't want you, I don't need you, I don't love you anymore and I would walk out of the door."*

It looks as if we have found our tower of strength.

WHEN AND HOW TO REPATRIATE OFFSHORE FUNDS

45 minutes CPD

▶ **MARK KORTEN,** mark@kortenconsulting.com

The current financial crisis could be an appropriate time for South Africans to bring back offshore funds. Our article guides readers through some scenarios and their respective tax implications.

The current lockdown in South Africa arising from the COVID-19 pandemic has severely impacted the South African economy and the financial position of South Africans, which in many cases has created unprecedented economic hardship. For those South Africans who structured their financial affairs in such a way that much of their savings and assets were taken or kept out of South Africa with approval of the Financial Surveillance Department (FSD) of the South African Reserve Bank, or in compliance with the Exchange Control Regulations, now is the time to consider the necessity of repatriating funds back to South Africa in order to address the shortfall in personal or business cash flow.

For those who have maintained their offshore funds in their personal names, this process is quite simple and does not trigger any specific South African tax event (other than the act of liquidating assets that would likely give rise to capital gains tax). All that is required is to follow the balance of payments banking protocols discussed below. However, where offshore assets have been structured in a tax and estate planning efficient manner through the use of an offshore trust, there are a number of issues to consider in order to ensure that the necessary repatriation of funds to South Africa is executed in a tax efficient manner.

A typical offshore trust scenario

With the correct South African tax advice, a South African settlor would have established an offshore trust in such a manner that it was not formed in South Africa and has its place of effective management elsewhere. This involves a leap of faith by empowering offshore resident trustees to have absolute discretion and control over the trust assets, which would include any request for distributions to South African resident beneficiaries. Typically, the South African settlor would have made a nominal donation to offshore trustees to be held for the benefit of discretionary beneficiaries. Further capital would have been introduced to the trust by way of an interest-bearing loan.

The offshore trustees would have applied the proceeds received from the South African settlor by making various investments for the long-term benefit of the trust's discretionary beneficiaries, either directly or through other planning arrangements involving establishing and owning offshore companies.

How to approach the trust

It is important to note that neither the South African settlor nor any other South African resident should have any right to demand any funds from the trust. An interested beneficiary should make a formal request to the trustees motivating the reasons why trust funds are needed, including a motivation as to why the sum being requested is appropriate. This process should be formalised in writing (email correspondence will suffice) which clearly evidences that it is the trustees' decision alone whether or not and how much to distribute to South African beneficiaries. This highlights the fact that no South African resident controls trust decisions but rather that an independent and unfettered decision is made by foreign resident trustees.

In theory, there are three ways in which to request funds from a trust. These are:

1. Repayment of a loan account claim against the trust
2. A request for a loan from the trust
3. A request for the trustees to make a distribution to a beneficiary (essentially a donation)

"For many South Africans the current financial crisis may be an appropriate time to bring back offshore funds."

Repayment of loans

In terms of section 31 of the South African Income Tax Act, any loan by a South African resident to an offshore trust is deemed to attract interest at the prevailing official rate of interest as published by SARS. This interest income should have been declared and would have been taxed in each year of accrual. The repayment of capital and interest accrued would therefore not give rise to any taxable event in the hands of the South African creditor, other than possible capital gains tax on any currency gain made on a loan denominated in a foreign currency that is converted back to rands. Clearly, if a loan account claim exists, this is the first and most tax efficient way of drawing funds from the trust. Only once such loan account claims have been depleted will it then make sense to request distributions to beneficiaries arising from the gains held by the trust that exceed the original loan capital introduced. The likelihood of substantial capital having been introduced to the trust by way of donations is unlikely given the donations tax exposure.

Request for loan funding

In theory a request for loan funding would be a tax efficient way to extract trust funds. However, the granting of a loan by a non-resident trust to a South African resident individual requires FSD approval in terms of the Exchange Control Regulations. It is the prevailing FSD policy not to approve a foreign loan to a South African resident borrower where the foreign lender is an entity in which South African residents have a direct or indirect interest. Such interest would include being a discretionary beneficiary of a foreign trust. The decision is based on the grounds that the loan would constitute a so-called "loop structure". It should be noted that by March 2021 the Exchange Control Regulations are expected to be substantially revised and there is a possibility that receiving foreign loans from an offshore trust may not be a contravention of the Exchange Control Regulations or FSD policy by 2021.

Beneficial distributions from the trust

The most likely scenario is that most of the trust fund represents the revenue and capital growth of the original funding or assets introduced to the trust when it was first established. Depending on the nature of such distributions, the South African tax burden may vary substantially. In terms of the common law rules relating to trusts, income of a trust which is distributed to its discretionary beneficiaries in the same financial year as receipt by the trust will be deemed to have accrued to its beneficiary in accordance with the so called conduit-pipe principle whereby the nature of the income in the trust is passed on to the beneficiary. This "flow through" principle has been followed in the wording and the operation of section 25B(2A) and paragraphs 80(2) and 80(3) of the Eighth Schedule to the Income Tax Act. The first with respect to revenue distributions arising from revenue receipts in previous financial years of a trust, and the latter with respect to capital receipts distributed by an offshore trust that arose from capital gains in a previous financial year of the trust.

These sections effectively provide for two scenarios where an offshore trust makes a distribution, in terms of a vesting of funds in the hands of a South African tax resident beneficiary, and the distribution represents income or capital gains derived by the trust in a previous year of assessment.

1. If the revenue or capital gains distributed would have been subject to South African income tax had the offshore trust been a South African tax resident in the year in which the income was received or accrued, then in the year of assessment when the distribution of the revenue or capital gain is vested in the hands of a South African beneficiary, the South African beneficiary is exposed to income tax or capital gains tax, as the case may be, on the distributions.
2. If the offshore trust would not have been subject to taxation on the revenue or capital gains that accrued to the trust in previous financial years had the offshore trust been a South African taxpayer, then the distribution of such revenue or capital gains to South African beneficiaries in a subsequent financial year would also not be subject to taxation in the hands of the beneficiaries.

Given the above application of the Income Tax Act, it becomes extremely important that at all times the trustees maintain the accounting records of the trust so as to carefully differentiate the following:

- The original capital introduced to the trust by way of donation or loan funding.
- The historical revenue gains of the trust, distinguishing that portion of historical revenue gains that would have been subject to South African tax had the offshore trust been a South African taxpayer, and that portion which would not have been subject to tax.
- The historical capital gains realised by the trust in previous financial years, again differentiating between which gains would have been exposed to capital gains tax in South Africa and which not, had the offshore trust been a South African taxpayer in the relevant years.

Having kept careful records as explained above, it then becomes critical that the trustees carefully allocate which portion of the historical gains are being distributed to South African beneficiaries. This should be recorded in a carefully worded trustee resolution. It will be in the interests of the South African beneficiaries to firstly allocate revenue and capital gains that would not have been subject to tax had the offshore trust been a South African taxpayer (thereby not exposing the beneficiaries to South African taxation on the distributions received). Only lastly should taxable gains be allocated with due regard to an effective 18% capital gains tax rate, a 20% tax rate on foreign dividends and a maximum marginal tax rate of 45% in respect of taxable revenue gains. The above investigation would invariably involve the trustees having to obtain considered South African tax advice before finalising any distribution to its beneficiaries, so as to incur the least possible tax exposure.

Practical examples

A few examples will be helpful to illustrate the above principles.

- If an offshore trust makes a distribution of foreign dividends received by it in a previous year arising from a minimum 10% and a maximum 50% shareholding in an offshore company, the offshore trust would have been exempt from South African tax had it been a South African taxpayer. This would be by virtue of the exemption on foreign dividend income provided for in section 10B(2)(a) of the Income Tax Act. It means that if this foreign dividend income is then distributed to South African resident beneficiaries in a later year, the distributions would also be exempt from tax in the hands of the South African recipients.
- If an offshore trust makes a distribution of foreign dividend income received by it in a previous year arising from less than 10% or more than 50% shareholding in a foreign company, had the offshore trust been a South African taxpayer it would have been subject to tax on foreign

"It would be in the interests of the South African resident beneficiaries to follow the relevant protocols to ensure that the repatriation of funds from an offshore trust attracts the lowest possible South African tax exposure."

dividends in South Africa. This means that if those foreign dividends are distributed to South African resident beneficiaries, the South African resident recipients would be subject to 20% tax on the beneficial distribution received.

- If a trust makes a distribution of capital gains realised in a previous year, the trust would have been subject to capital gains tax in South Africa and, accordingly, if those capital gains are then distributed to South African resident beneficiaries, the South African recipients are subject to capital gains tax at a maximum effective tax rate of 18%.
- If a trust derived trading profits or interest income in a previous year of assessment, the offshore trust would have been subject to full taxation on revenue gains had it been a South African taxpayer. This means that the distribution in a following year of the revenue gains will be subject to taxation in the hands of the South African resident beneficiaries at their respective marginal rates of tax.

The remittance process

The application of the Exchange Control Regulations in conjunction with the South African banking protocols requires that any transfer of offshore funds in foreign currency to the South African bank account of a South African beneficiary requires compliance with the balance of payments reporting process. This process involves completing an applicable balance of payments form to support the inward payment of foreign currency into a South African bank account in the course of an application to the bank to sell foreign currency and purchase South African rands. All of the South African banks have similar balance of payments forms to be completed. They require disclosure of the nature of the inflow of funds by choosing from a list of defined categories. Once the applicable balance of payments form is completed the South African bank will generally confirm an exchange rate for the conversion of the foreign currency inflows to South African rands. For large inflows it is advisable to shop around with various foreign currency exchange service providers that may provide a far more competitive exchange rate than the commercial banks.

Should the inflow represent the repayment of a loan account claim, generally one would consider what the nature of the original capital was that was advanced to the trust as a loan. For example, if this was historical foreign earnings paid by a foreign resident employer, this may be disclosed under category number 303 on the balance of payments form. If this was the annual discretionary allowance or personal investment allowance funds that a South African previously took out of South Africa for the purposes of lending to the trust, this return of foreign investment allowance may be cleared under one of the subcategories of category 511. In the case where the trustees make beneficial distributions to beneficiaries out of the funds held by the trust, this constitutes a foreign gift that would be declared in the balance of payments form under category 401.

For many South Africans the current financial crisis may be an appropriate time to bring back offshore funds. As has been illustrated above, it would be in the interests of the South African resident beneficiaries to follow the relevant protocols to ensure that the repatriation of funds from an offshore trust attracts the lowest possible SA tax exposure.

INVESTING OFFSHORE
THROUGH LOCAL INSTITUTIONS

CRAIG TURTON, cturton@purplegroup.co.za

Even with existing limitations, a fair amount of investing offshore is currently allowed. Our article describes various options for shifting funds offshore and looks at the advantages of working with a local advisor as opposed to an unreachable contact in some mysterious place abroad.

Investing in offshore funds has become very popular with South Africans, especially over the last decade. Clients mention the depreciating rand, uncertain politics, corruption, state-owned enterprises being a drain on the public purse, and rating agencies downgrading South Africa to junk status as the usual reasons for going offshore.

I believe there is a bigger conversation here. Yes, these are all good reasons to want to invest your money overseas, but there are many reasons to also invest in South Africa. Since the beginning of March, our business has reached record numbers with hundreds of thousands of clients investing billions through our platform in local companies. They are seeing the opportunities locally.

When is the right time to invest offshore and how?

My starting point would be to have a look at your balance sheet. How many of your assets are exposed to the South African economy? The major assets could be properties, retirement funds, business interests and share portfolios. I have found with the majority of my clients, at least 90% of their assets are exposed to our economy. If this is the case with you, then I would suggest gaining offshore exposure. Firstly, to include an alternate currency in your portfolio and, secondly, to invest in other countries and markets around the world.

Local platform or full offshore exposure?

You can choose to invest on a local platform denominated in rands but invested in offshore funds. A fund could be an exchange traded fund (ETF) or a unit trust fund. The key here is that the investment is domiciled here in South Africa and in rands. This structure is great if you would like offshore exposure through your tax free savings account or your living annuity.

But if you want full offshore exposure, then you need to go the direct offshore route and invest on an overseas platform and in a different currency. To do this you will need to apply for a tax clearance from SARS to ensure your affairs are up to date. However, SARS does give R1 million a year per taxpayer (older than 18) to invest offshore without the need for a tax clearance; this is called your single discretionary allowance. If you have more than this to invest you can then apply for your tax clearance to invest up to an additional R10 million.

Once you have decided that you would like to invest directly offshore, you will have various options to consider. You can choose to invest in direct shares on a share trading platform, or in a unit trust structure or you may wish to go into a wrapper structure which does come with some estate planning benefits.

If you and your spouse are taxpayers, you may donate to each other free of donations tax and each use the R1 million discretionary allowance.

The offshore investment world is a minefield with so many different options. If you feel that you need some guidance, then the use of a financial advisor is recommended. The alternative is to invest on a direct platform and make the investment decisions yourself.

Use an advisor or do it yourself?

Going through an advisor has a benefit in that the advisor knows and understands your portfolio in detail. They can plan for diversification in your portfolio, tax structures, estate planning measures and your history around money. Advisors are important in helping us remove emotions from situations and to ensure we make wise investment decisions. They will be able to guide you into an offshore structure that they are familiar with. Usually an advisory company would have a few different options in terms of asset managers they use and would also consider the risk category of the fund you will invest in. Using an advisor would come with a higher investment fee – usually between 0.50% and 1% of the fund value in the investment.

If you go the direct route, you will need to make these critical decisions yourself. It may seem daunting but a lot of the direct platforms in the market do assist in making some of these

decisions. An important aspect is to ensure that you are investing according to your risk profile. Do the tests on the platform and manage your portfolio as accurately as possible against this. Keep the bigger picture in mind as well. If you are a conservative investor but have money as surplus and are keen to take on higher risk with these funds, then find a fund that is outside your comfort zone.

I have found that using exchange traded funds through this route is the best way to invest. An exchange traded fund is essentially a basket of shares, bonds, property or cash. The fund has a specific market or sector in which it invests. Some examples of sectors to which these funds expose you are:

- S&P500 (this fund tracks the top 500 largest companies on the US stock market)
- Emerging markets
- Bonds
- MSCI International (a global equity index that represents large and medium markets in 23 developed countries)

Within these structures you will find different risk categories that will allow you to choose the right fund to invest in. This route is often more cost effective as you are doing the investing yourself.

An offshore investment structure is usually more expensive than a local investment. This is because the platform fee associated with investing offshore is higher and the managers are usually more expensive as well.

Is it time to convert my rands?

We often get asked the question: When is the time to convert my rands into dollars? As I am writing this article we are currently sitting on R18,66 to the dollar. By the time this article gets published it will probably be a very different number. But which way, up or down? My point is that trying to time currencies – especially in the times we are facing now – is very difficult. In 2016 I had clients that converted at R18 to the dollar. Around 2018 the rand strengthened to below R12 to the dollar. At this time none of these clients were upset about the exchange rate. They were just comfortable that they had funds at the time to convert into another currency. My feelings on currency is that if you have the funds to invest now, do not wait: convert and get them invested. Right now, markets are low so just the spike in returns could assist with the conversion rate if this concerns you.

Most platforms and advisors will also offer different currencies to invest in. If you choose to invest in specifically US shares, then your currency would be in dollars. If you choose to invest in the UK, then you would use the pound as a currency. However, some funds are spread across different countries and then the currency is only a reporting currency and is purely one that you are comfortable with.

An important factor to a lot of clients is that once you have sent the funds offshore, either through your single discretionary allowance or with a tax clearance, the funds never need to return to South Africa. If you do have a bank account in the UK or US, for example, the funds can be transferred there. This would apply through a financial planning company or a direct company.

Do not convert your rands into another currency and then leave the money in a bank account overseas. Overseas interest rates are so low that leaving money in a bank account with fees usually means a zero return. Ensure that you invest in an investment that will yield a return, or target a higher return over a period of time

South Africans abroad

I have had some clients who have moved to work overseas and left some of their assets here in South Africa. All these clients have struggled to find an advisor who works the same way as South African advisors. Overseas advisors see finances very differently to the way we do and do not understand our local investment or tax structures. For example, many of the European countries do not see saving for retirement as essential. This is due to government usually funding this. They also do not see the need for life and disability cover in many instances. Here in South Africa this is a vital component of financial planning.

This changes when you have selected to formally emigrate and have liquidated all assets in South Arica. You will then need to find an advisor in that country that can assist with your portfolio. Once again, ensure that your investment targets a higher return than cash.

Because the rand has weakened consistently against the bigger currencies over the years – and we do not see this changing – investing offshore is now a critical part of anyone's investment portfolio. Whether you do it through an advisor or through a direct platform, it is a good idea to get a strategy in place.

PROPOSALS AGAINST LOSSES DO THESE MAKE SENSE IN THE CURRENT CRISIS?

15 minutes CPD

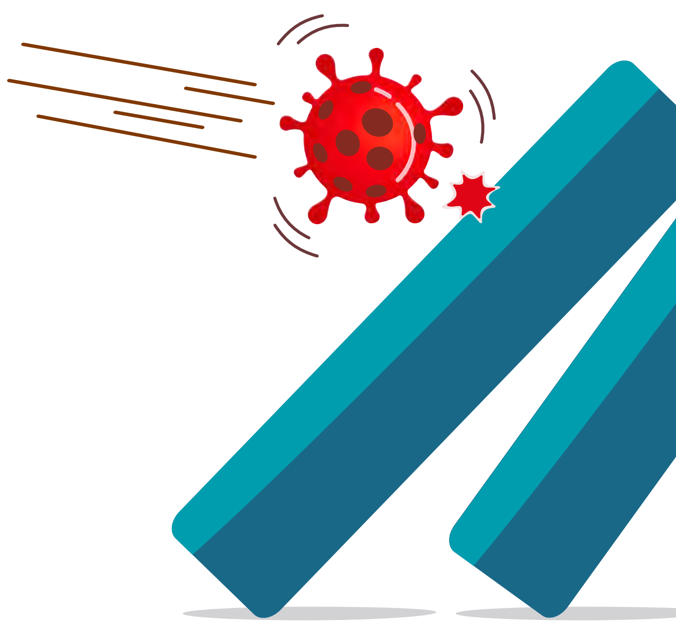
▶ **LESLEY BOSMAN,** lesley.bosman@kpmg.co.za

It seemed a fair trade-off between a gradual reduction in corporate rates and an overall limit on taking prior tax losses into account against the current year. Our article reviews the proposal against the backdrop of the impact that the COVID-19 pandemic will have on the global economy and in turn the South African economy.

On 26 February 2020, the Minister of Finance presented the 2020 Budget Speech. During the Budget Speech, it was announced that National Treasury is looking to broaden South Africa's corporate income tax base with a view to reducing the corporate income tax rate in the medium term. Included in the mechanisms to broaden the corporate income tax base was a proposal to restrict the utilisation of assessed losses carried forward to 80% of taxable income. This article looks at how the restriction is expected to operate as well as how the mechanism could broaden the corporate income tax base. Finally, this article looks at whether the proposed restriction is appropriate in the light of the large-scale disruption to the economy caused by the COVID-19 pandemic.

Unpacking the proposal

As with many of the Budget Speech announcements, little detail was given as to how the proposed restriction on the utilisation of assessed losses carried forward would operate. However, based on references to the proposal scattered throughout the various chapters of and annexures to the Budget Speech, the following elements can be distilled.



- The amendment is intended to come into effect in respect of years of assessment commencing on or after 1 January 2021. In other words, for a taxpayer with a year of assessment ending 30 June 2021, the amendment will apply from 1 July 2021.Taxpayers who carry forward assessed losses are currently able to set off the assessed loss against taxable income in full. Thus where the balance of assessed loss carried forward exceeds taxable income (before set-off of the assessed loss) for the year, no tax would be payable by the taxpayer. In terms of the proposal, taxpayers with assessed losses that are carried forward will only be able to apply that assessed loss to shelter 80% of taxable income derived in a particular year of assessment. Put differently, companies with an assessed loss carried forward will be subject to income tax on 20% of taxable income derived during any year. Where a taxpayer realises a current year loss and has no taxable income for the year, we envisage that no tax would be payable during that year of assessment.
- National Treasury expressly rejected the possibility of restricting the number of years for carrying forward assessed losses, stating that a proposal of this nature “would disproportionately hurt businesses with large initial investments or long lead times to profitability”. Rather, the proposal announced in the Budget Speech is “viewed as a reasonable approach that affects all businesses equally”. It therefore appears that the balance of any unutilised assessed loss will remain available to be carried forward, subject to the 80% restriction in future years.
- Whilst not expressly dealt with, we anticipate that taxpayers who realise a current year loss will be able to add the current year loss to the balance of any assessed loss that it carries forward to future years.

Taxpayers would ordinarily get their first glimpse at the proposed wording of the enacting legislation when the Draft Taxation Laws Amendment Bill is released for comment. This normally occurs around July of each year. It is not uncommon for provisions in the Draft Taxation Laws Amendment Bill to be substantially overhauled following the public commentary and consultation process. Taxpayers may therefore need to wait until the Taxation Laws Amendment Bill is tabled in Parliament later in the year to get any degree of comfort as to the final form of the proposals. The Bill is normally tabled in late October when the Minister of Finance presents the Medium-Term Budget Policy Statement. Further changes may be made to the Bill by, e.g., the Standing Committee on Finance but significant changes post the tabling of the Bill in Parliament are rare.

It remains to be seen what impact, if any, the COVID-19 pandemic will have on National Treasury’s legislative timelines.

How will the proposal broaden the tax base?

National Treasury and SARS released the latest annual “Tax Statistics 2019” in December. The latest tax statistics include an analysis of corporate income tax returns for the 2017 year of assessment. Trends identified from provisional tax payments made for the 2018 year of assessment are also analysed. The tax statistics reveal that 814 151 companies submitted tax returns and were assessed for the 2017 year of assessment. Of all the companies assessed 222 821 or 27.4% were in an assessed loss position. Only 197 707 companies or 24.3% of all companies were in a tax paying position. The remaining 393 623 companies (48.3%) reflected taxable income of nil. The tax statistics indicate that a number of taxpayers in assessed loss positions are carrying forward assessed losses realised during the global financial crisis of 2008 / 2009. The tax statistics also noted a downward trend in these assessed losses up until the 2016 year of assessment. A reversal in this trend was noted for the 2017 and 2018 years of assessment.

Where the decrease in the utilisation of assessed losses in the 2017 and 2018 years of assessment is significant, the effectiveness of the proposed restriction on the utilisation of assessed losses may be debateable. However, in the event that the statistics reveal that up to 27.4% of companies are currently generating taxable income (before the set-off of assessed losses) but are not currently paying corporate income tax as a result of losses realised nearly a decade ago, the case for the proposed restriction on the set-off of tax losses is clear. The real position is no doubt somewhere in

“The tax statistics indicate that a number of taxpayers in assessed loss positions are carrying forward assessed losses realised during the global financial crisis of 2008 / 2009

between the two extremes. The restriction on the set-off of assessed losses would have placed some of the 197 707 companies in a tax paying position for the 2021 year of assessment onwards. Many would, however, not immediately be impacted by the proposal, if enacted, on account of making current year losses.

Does COVID-19 warrant a rethink of the proposal?

Given the negative impact that the COVID-19 pandemic has had on the South African economy, taxpayers may be asking whether the proposed restriction on the utilisation of assessed losses is still appropriate. From an economic perspective, South Africa is arguably a very different country from the one addressed by the Minister of Finance on 26 February 2020. According to many economists, the global meltdown of 2008 / 2009 will pale in comparison to the impact that the COVID-19 pandemic will have on the global economy and in turn the South African economy. It is reasonably foreseeable that South African businesses will continue to feel the economic impact of the pandemic well into the 2021 year of assessment, if not beyond. Taxpayers making losses during the 2021 and subsequent years of assessment may be largely unaffected by the proposed restriction. Taxpayers who succeed in clawing their way back to profitability, and who would otherwise be able to rely on assessed losses carried forward to shelter taxable income, would be subject to tax at a minimum effective tax rate of 5.6% (being 20% of income taxed at 28%).

However, before jumping to the conclusion that the proposal should be shelved, it is important to consider the impact of the COVID-19 pandemic on other aspects of the budget. Per the 2020 Budget Speech, corporate income tax was anticipated to bring in R230 billion in revenue during the 2020 / 2021 budget cycle. This compares with R546 billion for personal income tax and R360 billion from value-added tax. For the 2021/2022 fiscal year, the 2020 Budget Speech projected revenues of R243 billion, R581 billion and R381 billion from corporate income tax, personal income tax and VAT respectively. These three taxes account for more than 80% of gross tax revenue.

If the pandemic results in large-scale job losses as predicted, the ability of the fiscus to collect personal income tax in the 2021 year of assessment will be adversely affected. The fall-out for business will likely result in lower corporate income tax collections. The subdued economy would also see lower consumption by individuals and business and thus lower VAT collections. Viewed in this light, a proposal that would see those companies that are deriving taxable income pay a minimum percentage of tax does not seem unreasonable.

In addition, the rationale behind wanting to broaden the corporate income tax base should be remembered. The current 28% corporate income tax rate is becoming increasingly uncompetitive relative to South Africa’s major trading partners. In the 2020 Budget Speech, the Minister indicated that National Treasury will consider reducing the South African corporate income tax rate to ensure the relative competitiveness of the country, to encourage businesses to invest and expand production and to reduce the incentive for base erosion and profit shifting. Without taking steps to broaden the tax base, it will not be possible to achieve these objectives.

Whilst we submit that there may be reasonable grounds for National Treasury to pursue the proposal, it remains to be seen whether the proposal will be enacted during the current legislative cycle.

TAX RELIEF IN A TIME OF UNCERTAINTY

▶ **BARBARA CURSON,** batier@icon.co.za

Our article takes a look at some relief for taxpayers affected by the lockdown in South Africa to combat the spread of COVID-19.*

The South African lockdown to mitigate the spread of the COVID-19 pandemic commenced on 26 March 2020. Initially mandated for a 21-day period, it was further extended to 30 April 2020.

Mindful of the impending negative economic impact arising from the pandemic, the National Treasury and SARS, on 1 April 2020, issued two draft Bills aimed at small and micro-businesses: the Draft Disaster Management Tax Relief Bill and the Draft Disaster Management Tax Relief Administration Bill. Comments were called for by 15 April, and the proposals became effective from 1 April to 31 July 2020.

The Draft Disaster Management Tax Relief Bill

The ambit of the Draft Disaster Management Tax Relief Bill is limited to small and medium-sized businesses, as National Treasury views those businesses as "the most vulnerable as they are unlikely to have cash reserves and are thus at a higher risk of shedding jobs under these conditions…" (refer to the National Treasury draft explanatory notes on COVID-19 tax measures).

The Draft Disaster Management Tax Relief Bill introduces limited relief by means of the Employment Tax Incentive Act (ETIA) for employees earning less than R6 500 per month, and provides for registration of a COVID-19 disaster relief trust. The amendments are operational for a limited four-month period from 1 April to 31 July 2020.

Despite the reference to medium-sized businesses in the explanatory notes, the Preamble to the Bill states that "commitments have been made to assist small businesses and their employees affected by the COVID-19 pandemic and Government is desirous of ensuring that those financial commitments have the maximum beneficial results". A small business is not defined in the Employment Tax Incentive Act nor in the Bill, though the Disaster Management Tax Relief Administration Bill limits "qualifying taxpayer" in the definitions under paragraph 1(b) to one "that has a gross income of R50 million or less during the year of assessment ending on or after 1 April 2020 but before 1 April 2021".

Enhanced employment tax incentive

The enhanced employment tax incentive (ETI) may only be claimed if the company is completely up to date with its tax returns and payments, and for the limited period from 1 April to 31 July 2020.

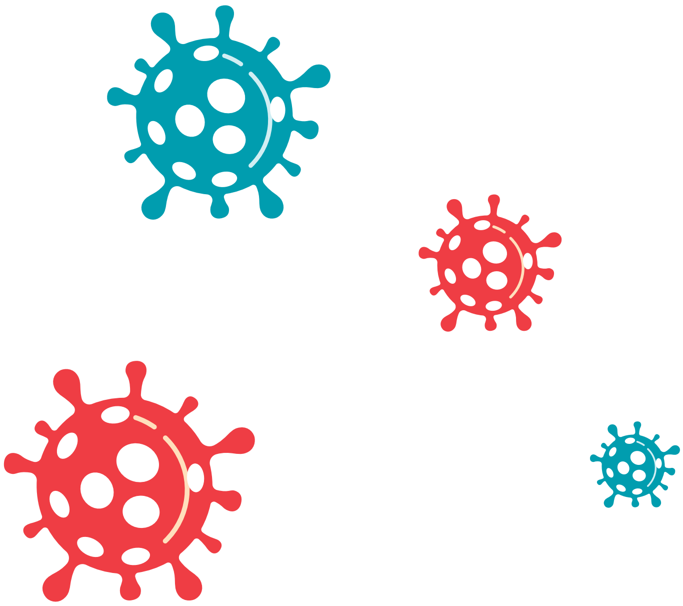
The enhanced ETI is claimable as follows:

First 24 months of employment

This incentive is only applicable to employees receiving remuneration of less than R6 500 per month, and may be claimed for three categories of "qualifying employees": those aged between 18 and 29, those employed in a fixed place of business located within a special economic zone (no age restriction), and those employed in an industry designated by the Minister of Finance (no age restriction).

In the first 12 months of employment

- Where monthly remuneration is less than R2 000, the ETI increases to R500 plus 50% of the monthly remuneration. The maximum amount that can be claimed is R1 500.
- For monthly remuneration between R2 000 and R4 500, the ETI increases to R1 500.
- For monthly remuneration between R4 500 and R6 500, the ETI is determined in accordance with the formula X = A-(B x (C-D)), where A represents R1 500, B represents 0.75, C represents the monthly remuneration of the employee, and D represents R4 500.



Employment between 13 and 24 months
- Where the monthly remuneration is less than R2 000, the ETI is the sum of R500 plus 25% of the monthly remuneration.
- For monthly remuneration between R2 000 and R4 500, the ETI is R1 000.
- For monthly remuneration between R4 500 and R6 500, the ETI is determined in accordance with the formula X = A- (B x (C-D)), where A represents R1 000, B represents 0.5, C represents the monthly remuneration of the employee, and D represents R4 500.

After the first 24 months
A new subsection has been inserted into section 7 of the Employment Tax Incentive Act, subsection (3A), which provides for qualifying employees who have already been employed for 24 months by the same employer, and receive remuneration of less than R6 500 per month. The incentive is applicable to: employees aged 18 to 29, employees aged 30 to 65, employees employed in a fixed place of business located within a special economic zone, and those employed in an industry designated by the Minister of Finance.
- For qualifying employees earning less than R4 500 per month, the ETI is R500.
- For qualifying employees earning between R4 500 and R6 500, the ETI is determined in accordance with the formula X = A-(B x (C-D)), where A represents R500, B represents 0.25, C represents the monthly remuneration of the employee and D represents R4 500.

The amendments apply to any remuneration paid on or before 31 July 2020 (from 1 April when the amendments are deemed to have come into effect).

Reimbursements may be claimed from SARS on a monthly basis, instead of every six months, in the form and manner and at the time and place prescribed by the Commissioner for SARS.

COVID-19 disaster relief trust
The Disaster Management Tax Relief Bill provides for the registration of a COVID-19 public benefit trust for a limited four-month period from 1 April to 31 July 2020.
- Any trust established for the sole purpose of disaster relief in respect of the COVID-19 pandemic (COVID-19 disaster relief trust) must be deemed to be a public benefit organisation, and must be approved by the SARS Commissioner.
- Any amount received or accrued from a COVID-19 disaster relief trust must be deducted or excluded from remuneration when calculating the balance of remuneration.
- Any COVID-19 disaster relief trust that has not been dissolved, and the assets of which have not been distributed by 31 July, will be deemed to be a small business funding entity and will be deemed to be approved as such by the SARS Commissioner.

"Mindful of the impending negative economic impact arising from the pandemic, the National Treasury and SARS on 1 April 2020 issued two draft Bills, aimed at small and micro businesses …"

** This article reflects the amounts, thresholds, percentages and other information contained in the Draft Disaster Management Tax Relief Bill and Draft Disaster Management Tax Relief Administration Bill, published on 1 April 2020.*

The Draft Disaster Management Tax Relief Administration Bill

The Draft Disaster Management Tax Relief Administration Bill provides for the deferral of employees' tax, provisional tax and interim tax payments for qualifying taxpayers that were registered with SARS as at 1 March 2020.

A qualifying taxpayer includes a tax-compliant company, trust, partnership or individual with turnover or gross income of R50 million or less in the year of assessment falling within the period from 1 April 2020 to 1 April 2021; and where the gross income amount does not include more than 10% of income in the form of interest, dividends, foreign dividends, property rental or remuneration received from an employer.

Deferral of employees' tax

Qualifying employers, either resident employers or representative employers, are allowed to pay just 80% of the employees' tax (PAYE) due during this period. The remaining 20% must be included in the gross amount due by the employer in six equal monthly instalments, starting on 7 September 2020 and ending on 5 February 2021.

This deferral will not attract interest or penalties. This relief is not available to employers who are in default with any returns or payments.

Deferral of provisional tax payments

The Bill allows for the provisional tax payments to be deferred as follows:

- If the first provisional payment (for the first six months of the tax year) falls between 1 April and 30 September 2020, 15% is payable instead of the 50% of the estimated provisional tax payable (less any employees' tax deducted by the taxpayer's employer and less any foreign taxes paid which qualify under section 6*quat* of the Income Tax Act).
- If the second provisional tax payment falls between 1 April 2020 and 31 March 2021, 65% of the estimated tax liability for the tax year is payable, less the first provisional tax payment, less any employees' tax deducted by the taxpayer's employer and less any foreign taxes paid which qualify under section 6*quat* of the Income Tax Act.

The deferred amount (the remaining 35% for the full year) must be paid at the time the third or "additional" provisional tax payment is made.

Deferral of micro business interim tax payments

A micro business can be a company, a close corporation or an individual with a turnover of less than R1 million. A qualifying micro business may pay the tax due as follows:

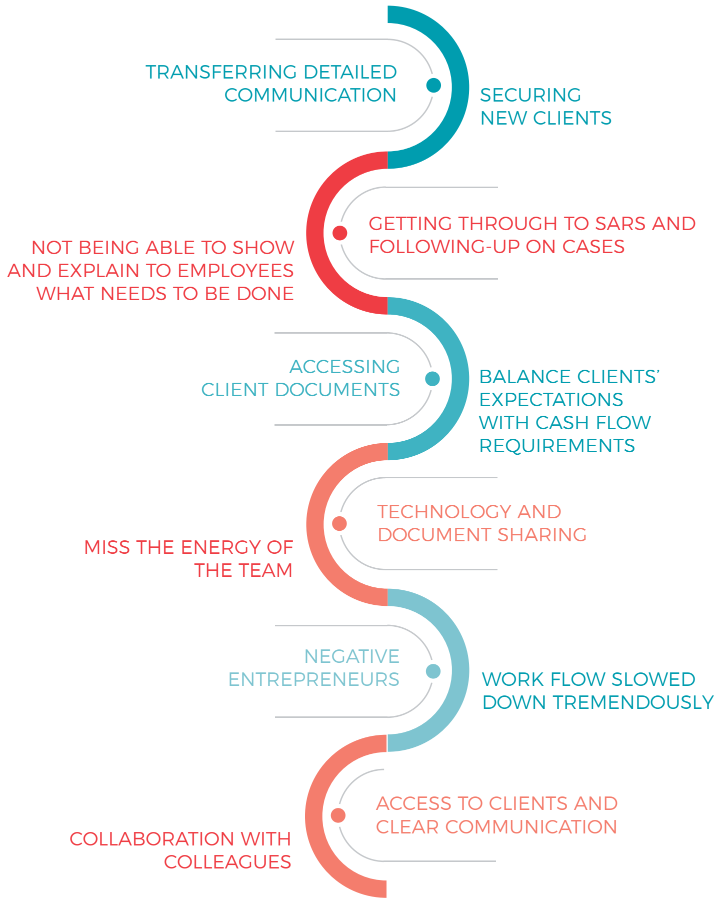
- If the amount of tax payable for the first six months of the tax year falls between 1 April and September 30 this year, 15% is payable instead of the 50% of the estimated tax payable.
- If the amount of tax payable for the tax year falls between 1 April 2020 and 28 February 2021, the amount payable is 65% of the estimated tax liability for the tax year, less the first amount of tax paid.

The interim payments deferred above will be due and payable by the micro business by the date of payment as specified in a notice of assessment.

This deferral will not attract interest nor penalties. However, interest and penalties will apply in instances where, on assessment, SARS is of the opinion that a taxpayer did not qualify for relief under the proposed amendments.

CORONAVIRUS IMPACT ON TAX PRACTITIONERS

SAIT members listed the following as some of the biggest challenges experienced during lockdown:



PRACTICAL APPLICATION OF THE COVID-19 TAX RELIEF MEASURES

▶ **KAREN VAN WYK,** kvanwyk@taxfaculty.ac.za & **DUANE NEWMAN,** dnewman@cova-advisory.co.za

National Treasury and SARS have introduced certain tax measures to temporarily relieve the pressure on cash flow of businesses. In this article, we explore what these measures are, how they provide relief and who would qualify for such relief.*

Tax relief measures

In a media statement issued by National Treasury and SARS on 29 March 2020, draft legislation and explanatory notes were published related to tax relief measures to mitigate the economic effect of the COVID-19 pandemic and the lockdown proclaimed to combat it. Once the legislation has been passed by Parliament and proclaimed, the measures contained in the two Bills will be deemed to have become effective on 1 April 2020. Three of the measures proposed are:

1. Expansion of the scope of relief provided in terms of the Employment Tax Incentive programme and also the value of this relief
2. Deferral of payment relating to employees' tax liabilities
3. Deferral of payment relating to provisional corporate income tax.

National Treasury has also given an indication of the requirements that must be met for the relief to be available to taxpayers.

Employment tax incentive broadened

The first measure proposes to expand the employment tax incentive (ETI) in respect of age eligibility criteria and the amounts claimable.

The ETI programme was introduced in January 2014. The incentive provides relief to employers via a reduction of the PAYE to be paid over to SARS. Its term has been extended on various occasions due to the programme being extremely successful in incentivising employment of South African youth (someone between the ages of 18 and 29) that earns less than R6 500 per month.

Under normal circumstances, ETI only provides for relief in the first 24 months of employment and the value of the benefit is capped at a maximum of R1 000 in the first 12 months of employment and a maximum of R500 in the second 12 months of employment.

Furthermore, where the ETI exceeds the PAYE withheld from the remuneration of such employees, a refund is claimable at the end of the reconciliation process, twice a year in February and August.

The tax relief proposals related to ETI are effective during the period 1 April 2020 to 31 July 2020 and can be summarised as follows:

NORMAL ETI PROGRAMME	ADDITIONAL RELIEF PROPOSED
ETI is only claimable in the first 24 months of employment	ETI is now claimable regardless of how long the employee has been employed
ETI is only claimable related to employees between the ages of 18 and 29 earning LESS THAN R6 500 per month	ETI is now claimable regardless of the age of the employee, as long as the employee is earning less than R6 500 per month
The maximum ETI benefit is capped at R1 000 in the first 12 months of employment and R500 in the second 12 months of employment	An additional R500 per month can now be claimed (i.e. increasing the maximum benefit to R1 500 in the first 12 months and R1 000 thereafter)
An ETI refund is claimable bi-annually	An ETI refund is claimable monthly

The first ETI claim that will be impacted by the abovementioned proposed relief will effectively be on 7 May 2020, as this is when PAYE is due.

Therefore, an ETI allowance can now be claimed for all employees earning less than R6 500 per month (regardless of their age and regardless of whether they have been employed for longer than 24 months).

Also please note that the abovementioned relief is only available to employers registered with SARS as at 1 March 2020.

To illustrate the scope of the relief, consider the following examples:

- Will additional ETI relief be claimable for a 35-year-old employee who earns R6 000 per month?
  - » Answer: Yes. R500 additional ETI relief can be claimed since the age requirement is not relevant during the period 1 April 2020 to 31 July 2020. (The relief is available not only for employees aged between 18 and 29 but for all employees earning less than R6 500 per month.)
- Will additional ETI relief be claimable for a 35-year-old employee who earns R7 000 per month?
  - » Answer: No. Additional ETI relief cannot be claimed since the monthly remuneration exceeds the maximum of R6 500.
- Will additional ETI relief be claimable for a 25-year-old employee who earns R5 000 per month and has been working for the employer for a period of three years?
  - » Answer: Yes. Normal ETI relief would have been claimed for the first 24 months of employment of the employee. Per the proposal, R500 additional ETI relief can now be claimed for this employee because the maximum term of 24 months has been removed for the period 1 April 2020 to 31 July 2020.

Deferral of PAYE

Employers are required to withhold PAYE from remuneration paid to employees in terms of the Fourth Schedule to the Income Tax Act. These amounts should then be paid over to SARS by the seventh day of the month following the month during which the PAYE was withheld. If the amounts are not paid over, penalties will be levied and interest charged relating to such late or non-payment.

The tax relief proposals related to PAYE are effective during the period 1 April 2020 to 31 July 2020 and can be summarised as follows:

- Small and medium-sized businesses (i.e. with an annual turnover of R50 million or less for the period ending April 2021) will qualify for the relief.
- Employers only need to pay 80% of the PAYE over to SARS by the seventh day of the following month without incurring penalties and interest relating to late payment.
- The balance of PAYE not paid over to SARS during the four-month period ending 31 July 2020, i.e. the remaining 20%, is deferred and becomes payable in six equal monthly instalments in the period August 2020 to January 2021 (i.e., the first payment will take place on 7 September 2020).

Non-compliant employers with outstanding returns or certain outstanding tax debt will not qualify for the proposed relief.

It is important to note that interest and penalties could still be levied for understatement of PAYE during the four-month period.

Consider the following example:

PERIOD	PAYE WITHHELD FROM EMPLOYEES' REMUNERATION	PAYMENT (80% of the PAYE withheld)	AMOUNT DEFERRED (20% of the PAYE withheld)
April 2020	R1 000 000	R1 000 000 x 80% = R800 000* * to be paid over on 7 May 2020	R200 000
May 2020	R1 050 000	R1 050 000 x 80% = R840 000* * to be paid over on 7 June 2020	R210 000
June 2020	R950 000	R950 000 x 80% = R760 000* * to be paid over on 7 July 2020	R190 000
July 2020	R900 000	R900 000 x 80% = R720 000* * to be paid over on 7 August 2020	R180 000
TOTAL	R3 900 000	R3 120 000	R780 000

Therefore, the amount not paid over (i.e., deferred) in terms of the additional relief proposal of R780 000 must be paid over to SARS in six equal monthly instalments of R780 000 / 6 months = R130 000 per month. The first instalment will be payable on 7 September 2020 and the last instalment on 7 February 2021.

It is important to note that the first PAYE deferral is therefore on 7 May 2020 (and not 7 April 2020).

Deferral of corporate provisional tax

The Fourth Schedule to the Income Tax Act requires that provisional taxpayers estimate their total taxable income and make provisional tax payments based on this estimate. Only if it can be justified, can an estimate be based on an amount lower than the taxpayer's basic amount.

Normally, the provisional tax payments are made as follows:

First provisional tax payment	Due six months after the start of the year of assessment	Equal to 50% of the total estimated liability	R200 000
Second provisional tax payment	Due on the last day of the year of assessment	Equal to the total estimated liability, reduced by the first provisional tax payment	R210 000

In case of noncompliance, SARS can impose two penalties:

1. A late payment penalty of 10% imposed in terms of paragraph 27 of the Fourth Schedule, in the case of late payment of the first or second provisional tax payment
2. An underestimation penalty of 20% imposed in terms of paragraph 20 of the Fourth Schedule, in the case of underestimation of the second provisional tax payment.

The tax relief proposals related to provisional tax are effective during the period 1 April 2020 to 1 April 2021 and can be summarised as follows:

NORMAL PROVISIONAL TAX	ADDITIONAL RELIEF
First provisional tax payment equal to 50% of the total estimated liability	First provisional tax payment equal to 15% of the total estimated liability
Second provisional tax payment equal to the total (i.e., 100%) estimated liability, reduced by the first provisional tax payment	Second provisional tax payment equal to 65% of the total estimated liability, reduced by the first provisional tax payment

It is interesting to note that the abovementioned proposal provides for relief without administrative penalties and interest being levied for late payment.

To avoid interest being charged on the remaining portion of the provisional tax liability (i.e., 35% of the total estimated tax liability which has been deferred) must be paid in the form of a third voluntary top-up payment:

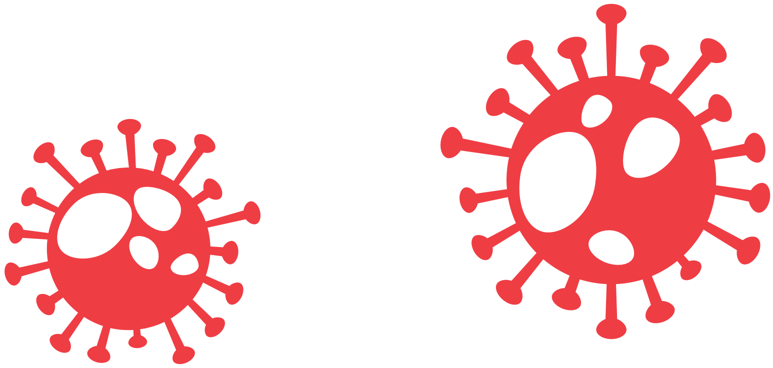
- seven months after the end of the year of assessment (in the case of a 28/29 February year of assessment); or
- six months after the end of the year of assessment in any other case.

The relief covers the following:

- First provisional tax periods ending on or after 1 April 2020 but before 1 October 2020; and
- Second provisional tax periods ending on or after 1 April 2020 but before 1 April 2021.

Small and medium-sized businesses (i.e., with an annual turnover of R50 million or less) will qualify for the relief. There is still uncertainty about whether natural persons who run businesses will qualify for the relief and what the eligibility criteria will be in that case.

"The tax proposals … are aimed at providing temporary cash flow relief to businesses in an attempt to curb the negative impact of the COVID-19 pandemic."



Cash flow relief

It is important to highlight that the current support package does not include any VAT deferrals or reductions, except those on offer under rebate item 412.11 on imported goods.

The tax proposals discussed above are aimed at providing temporary cash flow relief to businesses in an attempt to curb the negative impact of the COVID-19 pandemic. Businesses should investigate whether the relief mechanisms are available and should pursue these, where relevant.

** This article reflects the amounts, thresholds, percentages and other information contained in the Draft Disaster Management Tax Relief Bill and Draft Disaster Management Tax Relief Administration Bill, published on 1 April 2020.*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Case Law
Wrap-up

THOMAS LOBBAN, thomas@taxconsulting.co.za, ANDRE DANIELS, andre@taxconsulting.co.za & JEAN-LOUIS NEL, jean-louis@taxconsulting.co.za

We present recent judgments in cases dealing with penalties and interest imposed by SARS, the interaction between the interest provisions in the VAT Act and a VDP agreement and a diesel refund in respect of purchases in conducting mining operations.

ALFDAV CONSTRUCTION CC V SARS
(399/2017) [2020] ZAECPEHC (11 February 2020)

Issue
Whether a judgment made by the High Court, ordering the resubmission of VAT 201 returns by the taxpayer, may be clarified in terms of rule 42 of the Uniform Rules of Court to take into account the penalties and interest raised by SARS during the period granted by the Court for such resubmission.

Facts
The applicant (the taxpayer) brought an application before the Court to seek an order for it to resubmit VAT returns for the periods 07/2009 to 12/2013, within 60 days of the order, without incurring penalties and interest in respect of such resubmission.

The taxpayer was successful in its application, and the order was granted by the Court on the same terms as set out by the taxpayer.

The taxpayer later brought another application before the Court in terms of rule 42 of the Uniform Rules of Court. In this latter application, the taxpayer stated that in its understanding, the VAT 201 returns for the aforementioned periods were resubmitted timeously in terms of the Court's order.

This application was opposed by SARS, seeking to impose the penalties and interest against the taxpayer on the basis that the taxpayer had already admitted liability to SARS for the penalties and interest regarding the aforementioned VAT periods and requested a deferred payment arrangement in respect thereof.

The taxpayer's case
The taxpayer argued that the legal consequence of the order of the Court could not have been intended that the penalties and interest should be incurred in the submission of the VAT 201 returns.

Specifically, the taxpayer stated that the judgment of the Court should be read in the context of the pleadings. In this regard, in the main application the taxpayer sought an order to rectify the incorrect assessments for VAT in respect of the relevant periods, which assessments were reviewed and set aside by the Court. The taxpayer was accordingly ordered to resubmit the returns within 60 days from the date of the judgment, which order the taxpayer duly complied with.

Further, once the assessments challenged before the Court in the previous application were set aside, the penalties and interest imposed in terms thereof would also have been set aside. Hence, it would be absurd to penalise the taxpayer once again while it has complied with the Court order.

In addition, the taxpayer argued against SARS' contention that the taxpayer had already admitted liability for the penalties and interest on procedural grounds, being predicated on the basis that no leave was sought from the Court to file the affidavit in which this ground was raised by SARS. It was requested that, should the affidavit be allowed, the taxpayer should be given the opportunity to provide its response thereto.

SARS' case
In opposing the application, the respondent (SARS) argued that the penalties and interest arose due to late payment and not as a result of compliance with the judgment of the Court. In any event, the issue of penalties and interest was never raised before the Court in the previous application.

SARS went further to state that the procedure adopted by the taxpayer in respect of the present application was improper, as rule 42 of the Uniform Rules of Court cannot be used to supplement the original Court order, given that penalties and interest were never raised therein.

Further, SARS argued that it had an obligation to the Court to bring such facts as are relevant to the issues before Court. The taxpayer was in fact given an opportunity to indicate its stance on whether it intends to file further supplementary affidavits in this regard, but provided no response. Hence, the present application brought before the Court was moot for this reason.

Outcome

The Court ruled in favour of the respondent, SARS.

Core reasoning

Having read the pleadings in respect of the previous application, the Court found that the issue of penalties and interest were not specifically raised by the taxpayer and, therefore, it would be impermissible for the Court to vary the order to incorporate this.

For the purpose of comprehensiveness, the Court dealt with the argument raised by SARS that the application had become moot. Since the issue of penalties and interest had indeed already been resolved between the parties, the Court accepted that the present application would indeed have no practical effect for the taxpayer.

Further, the taxpayer had previously been given an opportunity to respond to the relevant affidavit alleging that the issue of penalties and interest had previously been resolved. Thus, the filing of a further affidavit by the taxpayer at that point would only delay the matter, as the facts could not be changed and the taxpayer had already admitted to its liability for the penalties and interest.

Take-away

It is crucially important for a taxpayer to raise all of the grounds on which a dispute is based, including all of the amounts in contention. Where relief is not specifically sought by the taxpayer, it cannot later be sought by that taxpayer following the conclusion of the said dispute. Further, a taxpayer may not later rescind an arrangement previously entered into with SARS or seek Court intervention once liability has already been formally admitted by the taxpayer to SARS.

MEDTRONIC INTERNATIONAL V CSARS

(33400-19) ZAGPPHC (17 February 2020)

Issue

What should be contained in a record for review proceedings and whether SARS may consider a request for the remission of interest in terms of section 39(7)(a) of the Value Added Tax Act once a taxpayer has agreed to pay such interest in terms of a VDP agreement under section 230 of the Tax Administration Act.

Facts

The applicant (the taxpayer) brought a review application against an assessment by SARS, in which interest was raised against the taxpayer.

The taxpayer was a victim of fraud, perpetrated by one of its employees, to the tune of approximately R460 million. An unfortunate effect of the fraud was that it placed the taxpayer in a non-compliant position with SARS.

The taxpayer applied for and was granted relief in terms of the Voluntary Disclosure Programme (VDP) as provided for in the Tax Administration Act. The parties then entered into a written VDP agreement in respect of the outstanding amount due to SARS.

Subsequently, the taxpayer applied for the remission of the interest imposed by SARS on the amount in terms of section 39(7)(a) of the VAT Act. This application was rejected on the basis that “as the agreements entered into between the Commissioner and the respective Taxpayers remain in force, the Commissioner cannot consider the request for the remission of the interest levied”.

As a result of the refusal, the taxpayer brought a review application against SARS before the Court. SARS informed the taxpayer that it had dispatched the relevant record of proceedings to the Registrar of the Court in terms of the Uniform Rules of Court.

The taxpayer alleged that the record did not comply with the relevant rules in that it "failed to contain the record of the proceedings relevant to the Commissioner’s decision sought to be reviewed and set aside by the taxpayer in the main application, such as internal memoranda, directives, policy documents, records of deliberations and minutes of meetings."

SARS’s legal advisors responded to the taxpayer and stated that SARS is only "in possession of emails and other internal correspondence with its legal advisors relating to the issue of remission of interest. The purposes served by such emails and other internal correspondence was to provide legal advice to our client on the disputed issue."

The taxpayer’s case

The taxpayer argued that SARS did not fully comply with the Uniform Rules of Court and did not supply the taxpayer with the information which led to the decision being taken to reject the application for remission.

The taxpayer further specifically contended that, due to SARS’ incorrect interpretation of the legal question, it had not made a decision on the merits of the taxpayer’s request for the remission of the interest. If the decision by SARS was based purely on a question of law, there is no reason why this should result in the exclusion of relevant information from the record.

SARS' case

In relation to the information not included in the record, the respondent (SARS) asserted its right to claim legal professional privilege in relation to the advice it received from its legal advisors and, in any event, the excluded documents were irrelevant for purposes of the review.

SARS further asserted that the decision to dismiss the taxpayer's application without considering the merits thereof was a question of law. This was based on SARS' interpretation of the provisions of the VAT Act and the Tax Administration Act: in view of the VDP agreement already concluded between the parties.

Outcome

The Court ruled in favour of the respondent, SARS.

Core reasoning

The Court held that it is trite that the usual grounds on which information is excluded from the record in review proceedings are irrelevance and legal privilege. What is considered to be relevant is not to be determined from the pleaded case, but rather from the decision sought to be reviewed. A Court remains guided by that which is relevant, for it is only relevant evidence that is admissible. In the present case, however, the information sought by the taxpayer would not be sufficiently relevant for its purposes.

Furthermore, the Court accepted that SARS' refusal to consider the merits of the request for remission was based upon its interpretation of the law, which is a matter in which the Court is required to adjudicate. In this regard, no discretion had in fact been exercised by SARS with regards to the remission of the interest as yet.

The taxpayer was aware that SARS' refusal to consider the remission of interest application was based on a legal issue, or otherwise stated, on the interpretation of section 39 of the VAT Act. The taxpayer, on its own version, was aware that the respondent did not base the refusal to consider the remission of interest on the merits. This resulted in the taxpayer attempting to review a decision that had not actually been taken.

Take-away

Taxpayers should exercise an abundance of precaution when entering into a VDP procedure with SARS and prior to entering into a VDP agreement, especially in view of penalties and interest raised in the face of mitigating factors. A VDP agreement is binding on both SARS and the taxpayer, and the taxpayer cannot later seek to change the agreed position in terms of a later request.

CANYON RESOURCES (PTY) LTD V CSARS

(68281/2016) (27 March 2019)

Issue

The issue in this matter relates to whether the taxpayer was entitled to claim a diesel refund in respect of diesel purchases in conducting its mining operations, in terms of section 75(1)(d) of the Customs and Excise Act and Schedule 6 thereto.

Facts

The taxpayer conducted open-cast coal-mining operations and utilised contractors for mining, washing, crushing and transport activities in the pursuit of its operations. During the course of 2012 and 2013, the taxpayer claimed a diesel refund from SARS in respect of diesel purchased from a supplier and on-supplied to its contractors in respect of its mining operations at either or both its collieries.

During November 2012, SARS expressed the view that the taxpayer's diesel refund claims in respect of the period February 2012–July 2012 ought to be disallowed, due to the fact that the taxpayer's contract with one of the contractors was a "wet" contract and the taxpayer's logbooks did not sufficiently record the quantity of diesel used and the purpose of each vehicle using such diesel. For the purpose of context, when a contractor is contracted on a "wet" basis, the contractor that supplies the distillate fuel with the vehicle, vessel, machine or other equipment contracted or hired will not qualify for a rebate.

During July 2013, SARS extended the period under investigation to include the period February 2012–May 2013 and resolved to disallow all the taxpayer's diesel refund claims as the contracts were also entered into on a "wet" basis and / or the logbooks used to indicate the diesel usage were not compliant with the requirements of Schedule 6 to the Customs and Excise Act.

The taxpayer lodged an administrative appeal, as provided for in the Customs and Excise Act, against the decision by SARS to disallow the diesel refund claims.

The taxpayer's case

The taxpayer and SARS both agreed that the question before the Court in relation to the contracts entered into was one of substance over form.

The taxpayer contended at length that some of the contracts did indeed provide for "wet" rates but noted that the contracts also made provision for "dry" rates. The taxpayer contended that the contractor would invoice the taxpayer on a "wet" basis and this would be converted to a "dry" rate by issuing credit notes or issuing credits. The reason for the elaborate procedure was to minimise the taxpayer's costs as the taxpayer did not want to pay a "dry" rate to contractors that are ineffective and not fuel efficient.

The taxpayer denied that it had effectively sold the diesel to the contractors, as it had received a "credit" or a reduction in respect of each invoice rendered to the taxpayer by these contractors in respect of each litre of diesel used by them in the generation of the services reflected in their invoices.

In terms of the record-keeping requirements provided for in Schedule 6 to the Customs and Excise Act, the taxpayer argued that substantial compliance with these requirements should be sufficient and that the requirements are merely directory and not peremptory.

SARS' case

The respondent (SARS) put forward its view that the taxpayer's operating procedure, whereby it is credited in each case, is the same as a purchase of diesel by the contractor and is logically sound – rather than actually paying for the diesel that the contractor used, the contractor would issue credit notes instead.

SARS further relied on the approach of the Court in *Maharaj & others v Rampersad 1964* (4) SA 638 (A) in which it was held, inter alia, that it "is not so much whether there has been `exact', 'adequate' or 'substantial' compliance with the injunction but rather whether there has been compliance therewith. This enquiry postulates an application of the injunction, to the facts and a resultant comparison between what the position is and what, according to the requirements of the injunction, it ought to be".

Therefore, SARS contended that the taxpayer was required to demonstrate with sufficient particularity "the journey the distillate fuel has travelled from purchase to supply" and then with equal particularity indicate the eventual use of every litre of such fuel in eligible purposes. Should the eventual use not be stated or sufficiently indicated, the claim fails. Should the volume of diesel used not be clearly determinable, the claim should also fail. Should the "journey" of every litre not be particularised, the claim would, once again, fail.

Outcome

The Court ruled in favour of the respondent, SARS.

Core reasoning

In terms of Note 6 and the definitions of "wet" and "dry" in the Act, it is clear that when a user contracts a contractor on a "wet" basis, the contractor procures diesel (and pays for it) and invoices the user with an invoice, which includes the total of the costs for services rendered and the diesel costs.

When a contractor is contracted on a "dry" basis, however, it invoices a user with a price or tariff which excludes the diesel. The reason for this is that the diesel is then supplied by the contractor at own cost. Therefore, the diesel is not sold to the contractors and / or paid by means of credit notes or credits on the account. The contractor then has no diesel expenses to pay by way of payment (or credits).

Hence, the argument raised by the taxpayer that the contractors "converted" their contracts to "dry" contracts was merely an attempt to avoid the prescripts of the Note to the rebate item and substance must prevail over form.

The Court found, on an analysis of the taxpayer's books of account, reconciliations and logbooks, that the details of the mining activities performed with the diesel in question were often absent. The volumes of diesel used, as appeared from the taxpayer's books, did not match the totals of credit notes issued or other credits passed by the contractors who used the diesel. The amounts of diesel used as disclosed in the logbooks of the contractors did not match the VAT reconciliations and showed significant monthly variances.

In the Court's view, the narrow factual disputes surrounding whether the taxpayer had indeed kept sufficient record of the usage of fuel had to be referred to oral evidence and the Court's discretion should be exercised in favour of the taxpayer. Where, such as in the case of a tariff appeal, a taxpayer is obliged to bring proceedings by way of a notice of motion and seeks to discharge an onus of proof which rests upon him by asking for an opportunity to adduce oral evidence or to cross-examine deponents to answering affidavits, the taxpayer should not lightly be deprived of that opportunity.

Take-away

Although this case deals at length with various aspects and whether the taxpayer is entitled to claim a refund in terms of the Customs and Excise Act, the fundamental principle reaffirmed here is that of the onus of proof on a taxpayer to substantiate their position taken and the principle of substance over form in respect of transactions entered into by a taxpayer.

In considering this judgment, a taxpayer must ensure that contemporaneous documentation is available to support any tax position taken by them and that such documentation falls within the confines of what is required in terms of the apposite prevailing legislation.

BINDING RULINGS

▶ **JASHWIN BAIJOO,** jashwin@taxconsulting.co.za & **THOMAS LOBBAN,** thomas@taxconsulting.co.za

We present two binding private rulings recently issued, and summarised here, dealing with the transfer of listed shares to a CIS in exchange for participatory interests in the CIS and a share buy-back at nominal value, as well as a binding general ruling extending the timeframe for the export of goods by vendors and qualifying purchasers affected by the global COVID-19 pandemic.

BINDING PRIVATE RULING 339

Transfer of listed shares to a CIS in exchange for participatory interests

Issue

The applicant and the fund approached SARS to determine the tax consequences of a transfer of listed shares from the applicant to a collective investment scheme in exchange for participatory interests in that collective investment scheme, in terms of sections 9C and 42 of the Income Tax Act and section 8(1)(a)(i) of the Securities Transfer Tax Act.

Facts

The applicant is a resident family trust, whose assets, amongst other things, comprise listed shares and immovable property. The fund is a resident collective investment scheme as contemplated in the Collective Investment Schemes Control Act.

The applicant seeks to transfer certain listed shares, which are held as long-term investments, to the fund. A portion of the listed shares have been held by the applicant for a period of at least three years, while the remainder have been held for less than three years, in which time their market value has far exceeded that of the base cost in the initial acquisition.

During this period, one of the trustees of the applicant has been acting as the investment manager for the listed shares and is the settlor in the matter at hand. A decision was taken by the trustees that the investment management and the administrative functions required in respect of the listed shares should be undertaken by the management of a professional investment fund.

As such, the applicant seeks to enter into an agreement in terms of which it will transfer the listed shares to the fund and, in exchange, will receive a participatory interest in the fund.

Ruling

The ruling issued by SARS is subject to the following additional conditions and assumptions:

- The fund meets all requirements to be considered a registered collective investment scheme as envisaged in section 1 of the Collective Investment Schemes Control Act.
- The acquisition of the listed shares by the fund will be as a long-term investment.
- After the proposed transaction has been concluded, the shareholdings in the various listed companies held by the fund shall not exceed the thresholds prescribed in paragraph (a) of the definition of "asset-for-share transaction" in section 42(1) of the Income Tax Act.

The ruling made in connection with the proposed transaction is in respect of the year of assessment ending 29 February 2020 and is as follows:

- Section 9C(2) of the Income Tax Act will apply to the listed shares that have been held for three years or longer by the applicant and the applicant will be deemed to have acquired the participatory interests in the fund on the dates the listed shares were acquired.
- The proposed transaction between the applicant and the fund will qualify as an “asset-for-share transaction” as defined in paragraph (a) of that definition in section 42(1) of the Income Tax Act.
- For purposes of section 42(2), the applicant may, in determining the cost at which it will acquire the participatory interest in the fund, include in the expenditure incurred the market value of the listed shares held for a period of more than three years on "valuation date”.
- The actual expenditure incurred in relation to the listed shares that do not constitute pre-valuation date assets, and which is allowed in terms of paragraph 20 of the Eighth Schedule, may be included in determining the cost at which the applicant will acquire the participatory interests in the fund.

- In accordance with section 8(1)(a)(i) of the Securities Transfer Tax Act, the transfer of the listed shares in terms of the proposed transaction will qualify for exemption from securities transfer tax.
- The sworn affidavit or solemn declaration contemplated in section 8(1)(a) of the Securities Transfer Tax Act is to be made by the public officer of the fund.

BINDING PRIVATE RULING 40
Share buy-back at nominal value

Issue
The applicant and co-applicant approached SARS to determine the income tax and donations tax consequences of a share buy-back at nominal value pursuant to a proposed cancellation agreement.

Facts
The applicant is a resident company and the co-applicant is a resident trust, owning 34.83% of the applicant's shares. Company A and Company B, both resident companies, hold 44.94% and 20.23% of the shares in the applicant, respectively. All shares were issued at a total subscription price of R1.00.

The subscription prices at which shares were issued to the co-applicant and Company B were determined by the board of directors of the applicant and deemed adequate consideration for purposes of section 40 of the Companies Act of 2008.

The shares issued to the co-applicant were issued in terms of an employee share ownership programme in accordance with the Broad-Based Black Economic Empowerment (B-BBEE) Codes of Good Practice in terms of the Broad-Based Black Economic Empowerment Act.

The co-applicant was primarily established to provide sustainable equity-based participation in the applicant, for the benefit of its beneficiaries; to ensure the sustainability and effective management of the applicant; and for the applicant to improve its BEE ownership status.

The co-applicant has not yet appointed beneficiaries, nor has the applicant declared a dividend since the co-applicant and Company B became shareholders, due to the share subscription transaction involving the co-applicant being incorrectly implemented.

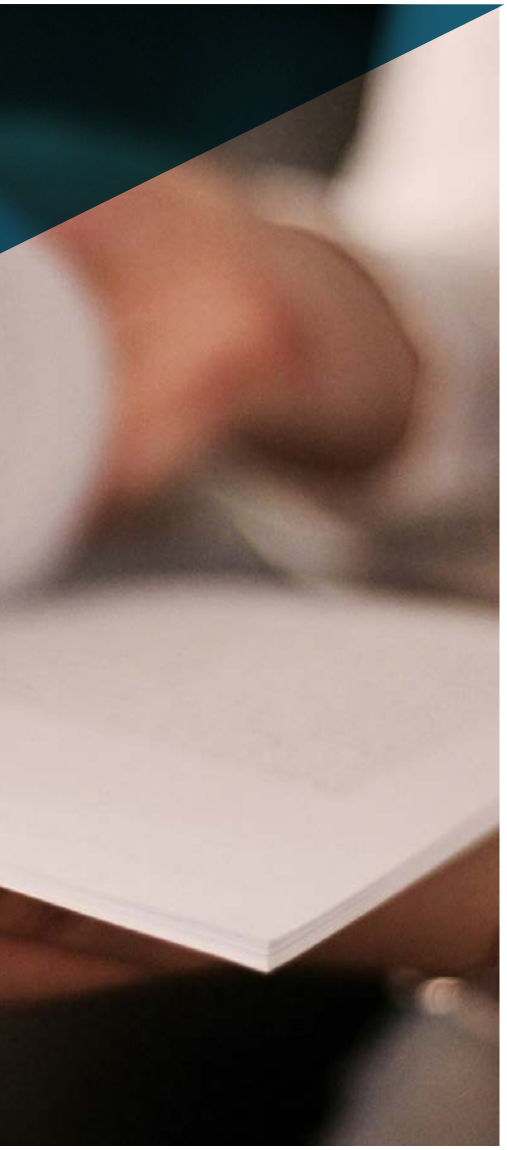
The intention was that the co-applicant should acquire and hold the shares in the applicant in a nominee capacity only. However, due to the structure and incorrect implementation of the transaction, the co-applicant has ended up holding its shares in the applicant as a discretionary trust and nothing more.

On this basis, the applicant and co-applicant propose entering into a restitution agreement which will terminate the subscriptions, returning each party to their position prior to the implementation of the transaction, resulting in its unwinding. The intention is to then implement a further share ownership plan, whereby shares will be reserved for issue to qualifying black employees. However, the applicant will place restrictions on the vesting and transfer of these shares by the applicant to the employees.

The restitution agreement will be effected by the applicant repurchasing all shares held by the co-applicant for the same consideration as at issue of the subscriptions, being R1.00. The applicant will cancel the repurchased shares and return them to its authorised and unissued share capital in accordance with section 35(5) of the Companies Act.

Ruling
This ruling is subject to the following additional conditions and assumptions:
- A resolution must be taken by the board of directors of the applicant authorising the repurchase of all the shares held by the co-applicant for the same consideration as at issue of the subscription, being R1.00 in aggregate. The resolution must clearly set out the proposed structure to be implemented subsequent to the share repurchase and expressly state the reasons that necessitated the repurchase; and confirm the reduction in contributed share capital of the applicant.
- The decision of the board of directors is to be approved via resolution of the shareholders of the applicant.
- A resolution must be taken by the trustees of the co-applicant authorising the repurchase of all of its shares held in the applicant for the same consideration as at issue of the subscription, being R1.00. The resolution of the trustees must clearly set out the proposed structure to be implemented subsequent to the share repurchase and expressly state the reasons that necessitated such repurchase.
- The applicant has 18 months from the date of the ruling to conclude, implement and give effect to the new employee share ownership scheme. An extension of this period may be applied for to the Advance Tax Rulings Unit of SARS.

The ruling made in connection with the proposed transaction is valid for a period of 18 months from 27 September 2019, and in terms thereof, the share repurchase by the applicant of its shares from the co-applicant for a consideration of R1.00–
- will not constitute a disposal by the applicant in terms of paragraph 11(2)(b) of the Eighth Schedule to the Income Tax Act.
- will constitute a disposal by the co-applicant in terms of paragraph 11(1)(a) of the Eighth Schedule.
- will not, in the specific facts and circumstances, result in the application of paragraph 38(1) to the transaction.
- will not give rise to a "dividend" as defined in section 1(1) of the Income Tax Act.
- will not give rise to an inclusion in the "gross income" of the co-applicant as defined in section 1(1).
- will not give rise to a "donation" as defined in section 55(1).
- will not give rise to a deemed donation in terms of section 58(1).



BINDING GENERAL RULING 52
Timeframe for the export of goods by vendors and qualifying purchasers affected by the global COVID-19 pandemic

Issue

This binding general ruling extends the time periods to export movable goods, apply for a refund from the VAT Refund Administrator and obtain the relevant documentary proof of export, as stipulated in the Export Regulations and IN 30 respectively.

Facts

The Export Regulations and IN 30 respectively prescribe the time periods to export movable goods, apply for a refund from the VAT Refund Administrator and obtain the relevant documentary proof of export.

The Export Regulations and IN 30 allow for an extension of the aforementioned time periods where these periods cannot be met because of circumstances beyond the control of the qualifying purchaser or the vendor. These circumstances include a natural or human-made disaster, and a serious illness of the vendor, qualifying purchaser or the person duly authorised to represent the qualifying purchaser.

In light of the COVID-19 pandemic, and the measures put in place by the President of South Africa regarding the pandemic, qualifying purchasers and vendors will have difficulty in meeting the aforementioned prescribed time periods set out in the Export Regulations and IN 30 respectively. This situation is considered to be beyond the control of the vendor, the qualifying purchaser or the person duly authorised to represent the qualifying person, as contemplated in the Export Regulations and IN 30 respectively.

Ruling

This ruling constitutes a Binding General Ruling under section 89 of the Tax Administration Act, insofar as it applies to direct and indirect exports as set out hereunder, and applies from the date of its issue until it is withdrawn, amended, or the relevant legislation is amended.

This ruling only applies to supplies of movable goods in respect of which, at the date of issue of this ruling, the original prescribed timelines referred to in the Export Regulations and IN 30 respectively, have not yet been exceeded.

Indirect exports

Time period to export movable goods under Part One

The time period prescribed under Regulation 3(a) of the Export Regulations to export movable goods is extended by an additional three months.

Time period to apply for a refund under Part One

The time period to apply for a refund prescribed in Regulation 3 of the Export Regulations is extended to six months from the date of export, in respect of the circumstances contemplated in Regulation 6(a) of the Export Regulations.

Time period to export movable goods under Part Two Sections A and B

The time period to export movable goods prescribed under Regulation 15(1) and (2)(a) to (e) of the Export Regulations is extended by an additional three months.

Direct exports

Time period to export movable goods under direct exports

The time period prescribed in paragraph 5 of IN 30, to export movable goods, is extended by an additional three months.

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