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Tax Alert

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# Foreign Remuneration Exemption – what will the changes mean?

Effective from 1 March 2020, changes will be made to the Foreign Remuneration Exemption, which are likely to impact many South Africans working temporarily abroad.

Currently, the foreign remuneration exemption contained in Section 10(1)(o)(ii) of the Income Tax Act No 58 of 1962 ("ITA") states that foreign remuneration earned by a South African resident taxpayer will not be subject to South African income tax if the taxpayer has spent more than 183 days rendering services outside of South Africa in a rolling twelve month period, of which more than 60 days were consecutive.

The change to the legislation means that the remuneration earned for foreign services will no longer be completely exempt from South African income tax (assuming that the taxpayer met all the requirements for the exemption to apply). From 1 March 2020, only the first R1 million of remuneration relating to foreign services will be exempt from South African tax (assuming that the taxpayer meets all of the requirements for the exemption to apply).

On 6 March 2019, a workshop was jointly hosted by National Treasury (NT) and the South African Revenue Service (SARS) with various stakeholders, to address practical concerns arising as a result of the legislative amendment. It was confirmed that the legislation will not be amended any further, and the implementation date will not move out beyond 1 March 2020. SARS also confirmed, however, that there is a willingness to work with taxpayers to ensure that the implementation is as smooth as possible. So the question is, what are the practical concerns? What are the likely consequences of the change, effective 1 March 2020?

### Employees' Tax

South African employers who pay remuneration for foreign services via a local South African payroll, may cease to withhold South African employees' tax in relation to qualifying foreign remuneration. Where the employee fails to meet the requirements of section 10(1)(o)(ii), however, the employer becomes liable for the withholding of employees' tax due to SARS, and the employer is liable for penalties and interest that result.

Where a South African resident earns foreign sourced income and pays foreign tax in respect of that income, it is also taxable in South Africa, and he may claim foreign tax credits ("FTC's") against the SA tax due in respect of that income, subject to certain limitations.

Currently the Fourth Schedule of the ITA does not specifically allow for FTC's to be applied through the payroll to reduce employees' tax liability to SARS. The impact of this, is that where an employee either doesn't qualify for the exemption, or earns more than the R1m exemption after 1 March 2020, and pays tax in the foreign country he is working, there is an inevitable cash flow problem created. He will pay tax in both countries on his foreign income (or the portion greater than the R1 million exemption). This is an unintended consequence that will need to be resolved before the legislation becomes effective. There are two options to enable resolution – either the legislation needs to be amended to allow for the FTC offset, or a specific ruling would need to be obtained from the Commissioner to allow for the offset, for each employee concerned. This is potentially administratively burdensome for taxpayers, employers and SARS, but is currently the only solution available.

## Foreign tax credits (FTCs)

A resident taxpayer is required to report all local and foreign income (remuneration, interest, dividends and rental etc.) in his provisional and annual tax returns and he would be entitled to claim FTC's to reduce the South African tax liability. Additional South African taxes will be due where the FTC's are insufficient to cover the South African tax liability on the worldwide income.

Section 6quat of the ITA provides that FTC's may be claimed to the extent that the foreign taxes are "*paid or proved to be payable*". A difficulty experienced by taxpayers is that it is often difficult to obtain proof of taxes to be paid, and there is lack of clarity as to what would constitute sufficient proof of payment or proof of liability, where taxes have not yet been paid.

Globally, individual taxes are paid in different ways and through differing mechanisms. Some countries have self-assessment tax return systems, where no assessments are issued. Others have monthly taxes payable by employers on behalf of their employees, and others have payroll withholding, which is not a final tax, and does not has assessments that reflect the taxes paid or payable. So proving the payment of foreign taxes is difficult for employees, and even more difficult on a "real time" monthly basis, to enable offset through SA payroll.

Although this problem in relation to the claiming of FTC's already exists for those employees who don't qualify for the exemption, and who are taxable in the country in which they work, it is on a much smaller scale, and has not created a large amount of concern as a result. Given the likely impact of the change to the legislation, it is essential that the question around what would constitute sufficient proof for the offset of FTC's, is answered before it becomes effective. Time is, however, running short for this.

Given the cash flow difficulties likely to be experienced by employees working abroad and paid from South Africa, there is a likelihood that South African residents may seek alternative solutions, such as breaking South African tax residence, resulting in being taxed on South African sourced income only going forward. This does not come without challenges, however, and is not always possible for foreign employees on temporary assignments abroad.

## Breaking South African Tax Residence

Much has been discussed about the term "Financial Emigration". This is not a tax term and is in fact not necessary to break tax residence in South Africa. Tax residence can be broken by a South African citizen, who is ordinarily resident in South Africa, in one of two ways:

- By leaving South Africa and deciding not to return – settling permanently outside of South Africa, with or without formal emigration (breaking ordinary tax residence); or
- By becoming resident in the foreign country in which he works, and by applying the "tie breaker" clauses contained in the Residence article of the applicable Double Tax Agreement concluded between South Africa and the other tax jurisdiction (breaking residence through the application of a DTA).

From the above, it is clear that one cannot simply "decide" not to be a tax resident in South Africa any longer and expect that SARS will accept this decision. A decision must be backed by facts and circumstances, and a balance of evidence, should SARS query the residence status.

On breaking residence, it is important to note that a South African taxpayer will be deemed to have disposed of all worldwide assets, excluding South African immovable property, at market value on the day before breaking residence – an "exit charge". The total gain calculated, less R40,000, will result in the net gain for inclusion in taxable income. 40% of this gain must then be included in income and taxed at the taxpayer's marginal rate. If a South African resident taxpayer holds assets which have grown significantly in value since acquisition, and have not been disposed of, this could be a very costly exercise, while not having liquidated these assets in order to cover the cost of the tax due.

## Conclusion

The area relating to the application of FTC's needs urgent legislative clarification to enable proper implementation by taxpayers, employers, tax practitioners and SARS alike. SARS assessors and auditors need to be trained and equipped to deal with the likely increase in the application of FTC's through payrolls (assuming rulings can be obtained from the Commissioner) and through annual tax returns.

Tax resident individuals employed abroad should critically evaluate their South African tax residence position, to determine whether they remain tax resident in South Africa or not, and ensure that they fully evaluate their global tax position and understand what will be required of them from 1 March 2020, and what the likely cost implications will be if they remain South African tax residents. Each individual's circumstances need to be addressed on a case-by-case basis.

Advice should be sought well in advance of March 2020, to ensure advance planning and careful consideration of all of the possible consequences.

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