Tax Alert

May 2019

The “not so obvious” consequences of the changes to the foreign earnings exemptions.

With effect from 1 March 2020, Section 10(1)(o)(ii) of the Income Tax Act, No 58 of 1962 (“the Act”) commonly referred to as the foreign earnings exemption, will be amended. The amendment will limit the application of the exemption to the first ZAR 1 million of income for employment services rendered outside South Africa in respect of a year of assessment.

While much has been said about how the changes to Section 10(1)(o)(ii) will impact individual’s tax liability in respect of foreign employment income, not a lot of emphasis has been placed on the “not so obvious” consequences of the changes.

Income from other sources

Many South African tax residents working abroad maintain income generating investments in and outside of South Africa. These include rental properties and share portfolios.

Under the current legislation, where foreign employment income can be fully exempted, the income from these investments are likely taxed at a lower rate. If the income is substantial enough to push the individual into the highest marginal tax rate (foreign employment income aside), the benefit of the tax bands and individual rebates will reduce the final tax liability at the very least.

However, as an individual's taxable income will increase as a result of the change, a higher rate of tax will be applied to income from other sources. This will be the case even if a foreign tax credit is available to effectively extinguish any South African tax liability on the foreign employment income, as the credit reduces the taxes due and not the income subject to tax in the way the current exemption does.

Example:
A person is earning income for foreign services of ZAR 2 million per annum and taxable South African sourced rental income of ZAR 150 000 per annum. He fully meets the requirements to qualify for the foreign remuneration exemption. A tax credit of the full value of South African tax due on the foreign employment income is available.

For purposes of this illustration we have applied the 2020 tax table for both scenarios.

	Current exemption (ZAR)	After amendment (ZAR)
Employment income	2 000 000.00	2 000 000.00
Rental income	150 000.00	150 000.00
Section 10(1)(o)(ii) exemption	-2 000 000.00	-1 000 000.00
Taxable income	**150 000.00**	**1 150 000.00**
Normal tax liability	27 000.00	388 540.49
Primary rebate	- 14 220.00	- 14 220.00
Foreign tax credit		- 325 496.08
Tax due	**12 780.00**	**48 824.41**
Additional tax liability as a result of the amendment		36 044.41

Capital gains tax

Similarly, taxable capital gains will be subject to a higher rate of tax as a result of the amendment.

Compliance obligations

The definition of “provisional taxpayer,” set out in paragraph 1 of the Fourth Schedule to the Act, includes any person who derives income by way of remuneration from an employer that is not registered for South African employees’ tax. A person who does not derive income from carrying on any business and whose taxable income is less than the tax threshold would be excluded from the definition.

Accordingly, if a person working abroad is remunerated by a foreign employer, that person would be regarded as a provisional taxpayer in terms of the first part of the definition. However, under the current legislation, the person can again be excluded from the definition if their only source of income is employment income and that income is fully exempt (i.e. they do not have taxable income in excess of the tax threshold).
Following the amendment, the individual will not be excluded to the extent that they have taxable income in excess of the tax threshold as a result of the reduced application of the exemption.

Why does this matter?

South African tax residents working abroad should prepare not only for the added administration to remain tax compliant while abroad but also for the potential additional tax liability they might incur. This applies especially to individuals who have qualified for the exemption in the past as they might not realise how much more tax they will need to pay than in the past on income from other sources.

While many employers with a mobile workforce have policies in place to protect an employee on a temporary assignment from adverse tax implications of their assignment, the application of these policies are generally limited to income from employment. Therefore, employers who do not offer protection on personal income should make their employees aware of how the changes might impact them while those who do need to consider the additional cost they will incur in this regard.

Should you have questions or require any assistance in planning for the change in legislation, please contact us:

Melissa Duffy

Sarika Rautenbach
Associate Director: Global Mobility Services &

Director: Global Mobility Services &
Employment Tax Advisory
T: +27 82 448 1989
E: melissa.duffy@kpmg.co.za

Employment Tax Advisory
T: +27 82 719 5685
E: sarika.rautenbach@kpmg.co.za

Privacy | Legal

kpmg.co.za

© 2019 KPMG Services Proprietary Limited, a South African company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ('KPMG International'), a Swiss entity. All rights reserved.