27 February 2019

Global Tax Alert

South Africa: Update on foreign income exemption

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

South African Legislation was promulgated on 18 December 2017, amending the foreign income exemption available to South African residents working abroad. In terms of the revised legislation the exemption was capped at ZAR1 million (approx. US$67k) of the foreign-earned remuneration per annum, to be effective **1 March 2020**.

Background

South African residents rendering services outside of South African borders have been able to apply the exemption to the foreign income earned, if they complied with the following exemption requirements:

- The remuneration must be received by or accrued to the individual for services rendered abroad during the qualifying period.
- The individual must be outside South Africa for more than 183 full days in aggregate, in any 12-month period commencing or ending during that tax year.
- At least one period of absence must be for a continuous period of more than 60 consecutive full days during the same 12-month period.

According to the National Treasury, the tax exemption of foreign employment income appeared excessively generous, therefore, an amendment to the legislation was required.

Building a better working world

The amendment limits the exemption to ZAR1 million of foreign remuneration, from the tax net in South Africa. Any excess in the foreign remuneration will be subject to tax in South Africa, and a foreign tax credit may be applied, if tax is payable on the same income in the country where the individual is rendering services.

Impact of the amendment

The amendment has a direct impact on the individual as the tax liability may increase. In most cases this impact will be carried by employers, which in turn will impact project costs.

Since the amendment to the legislation was enacted in 2017, there has been no communication from the South African Revenue Service (SARS), providing guidance to taxpayers or employers. In the 2019 Budget Speech, on 20 February 2019, it was announced that SARS would be consulting taxpayers on their administrative concerns. We have been notified of a workshop to be held by SARS on 6 March 2019, in which this consultation process will commence.

Until further information and clarity is provided on the practical implications, individuals and their employers should consider the extent of the impact. There are a variety of factors which may influence the financial impact of this change, from the existing company policy to the tax jurisdictions, with their varying tax rates, to which assignees are seconded to. Without performing some financial modelling, individuals and companies will not be prepared with the necessary information to make an informed decision regarding next steps.

From an individual perspective, many taxpayers are considering the longer-term impact and whether ceasing South African tax residency is the most feasible option.

Breaking tax residency

South African tax legislation outlines **two tests** to determine the tax residency status of a natural person. The first test is to determine whether a person is ordinarily tax resident in South Africa. Where a person is not ordinarily resident, then the second test is applied, namely, the physical presence test.

A person will still not be regarded as a South African resident if the person is regarded as exclusively resident of another country as per the Double Taxation Agreement (DTA) between that country and the Republic of South Africa.

As a South African tax resident, there are two ways in which a taxpayer may cease to be a resident:

1. By becoming exclusively a tax resident in another country with which South Africa has a DTA.

Or

2. By breaking "ordinarily residence," as South Africa is no longer seen as their permanent home.

If by applying the tie- breaker clause of the DTA, it is concluded that the person is a resident of another country, the person may cease to be resident in South Africa. This has to be reported on the South African tax return.

An ordinarily resident taxpayer may cease tax residency in South Africa, if a conscious decision is made not to return to South Africa, and there is a clear intention to become a resident of another country.

A day before the individual ceases residency, there is a deemed disposal of the individual's assets which will trigger a capital gain/loss subject to Capital Gains Tax (CGT). This tax cost must be considered before deciding to break residency.

Financial emigration

A person's tax residency status should not be confused with such person's exchange control status. While formally emigrating is a factor supporting a person's intention to severe ties with South Africa and hence to cease their ordinarily residence status, the concepts are not mutually exclusive.

South African citizens/ordinarily residents are foreign exchange residents. South African residents who wish to formally emigrate will need to cease their exchange control status in South Africa.

The financial emigration process includes an application to the South African Reserve Bank (SARB), which is facilitated by an authorized dealer, to place on record the intention of formal emigration.

One of the SARB requirements for emigration is a tax clearance certificate that is obtained from SARS. The tax emigration process has to be followed and as previously mentioned, a CGT will be applied on the gain/loss on the deemed disposal of the assets.

Financial emigration should not be considered if the individual is not clear regarding his/her intentions.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Advisory Services (Pty) Ltd, Johannesburg

- Cinzia De Risi cinzia.derisi@za.ey.com
- Elizabete Da Silva elizabete.dasilva@za.ey.com
- Vedika Andhee vedika.andhee@za.ey.com
- Gabrie Combrinck gabrie.combrinck@za.ey.com
- Elriette Butler elriette.butler@za.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 000663-19Gbl

1508-1600216 NY
ED None

ey.com