AN INVESTIGATION INTO THE TAX CONSEQUENCES FOR INDIVIDUALS PERFORMING WORK ABROAD

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ABSTRACT

This thesis considered the income tax implications for South African tax resident individuals who render services abroad. The research included an analysis of the impact that the amendment to the section 10(1)(o)(ii) exemption has on individuals rendering services abroad and companies who send their employees abroad. In doing so, this thesis sought to highlight the key factors for consideration, for both employers and individuals.

A doctrinal methodology was applied, and an analysis was carried out of relevant tax legislation, commentary of experts in the field of tax law and the relevant case law of South Africa, the United Kingdom (UK), Australia and the United States of America (US), where relevant.

It was established that residency is key to determining the tax liability of a person and has an impact on the relief mechanisms that are available where double taxation arises. In addition, the amendment to section 10(1)(o)(ii) was considered. It was concluded that when rendering services abroad, both the employer and employee need to consider the tax consequences that may arise and highlights the factors which may be relevant. The thesis illustrates that, whilst the R1 million exemption alleviates the double tax consequences to a certain extent, further guidance is needed as to how the R1 million threshold will be calculated.

Key words: Foreign employment, foreign employment income, foreign tax relief, double tax, double tax relief, South African residency, section 10(1)(o)(ii) exemption, South African Income Tax Act, foreign employment exemption.

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TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION.......... 7

1.1 RESEARCH CONTEXT.......... 7
1.2 GOALS OF THE RESEARCH.......... 10
1.3 METHODS, PROCEDURES AND TECHNIQUES.......... 11
1.4 ETHICAL CONSIDERATIONS.......... 12
1.5 OVERVIEW.......... 12

CHAPTER 2: ESTABLISHING THE TAX "RESIDENCE" OF A NATURAL PERSON.......... 14

2.1 INTRODUCTION.......... 14
2.2 A SOURCE-BASED SYSTEM OF TAXATION.......... 15
2.3 RESIDENCE-BASED SYSTEM OF TAXATION.......... 17
2.3.1 Ordinarily resident.......... 18
2.3.2 Physical presence test.......... 22
2.4 TAXES IMPOSED IN SOUTH AFRICA.......... 23
2.5 DOUBLE TAXATION.......... 25
2.6 CONCLUSION.......... 25

CHAPTER 3: DOUBLE TAX AGREEMENTS.......... 28

3.1 INTRODUCTION.......... 28
3.2 OBJECTIVE OF DOUBLE TAX AGREEMENTS.......... 29
3.3 DOUBLE TAX AGREEMENTS AND THE CONSTITUTION.......... 30
3.4 APPLICATION OF DOUBLE TAX AGREEMENTS.......... 31
3.5 CONCLUSION.......... 37

CHAPTER 4: OVERVIEW OF THE DOMESTIC DOUBLE TAX RELIEF MECHANISMS AVAILABLE TO A SOUTH AFRICAN TAX RESIDENT.......... 39

4.1 INTRODUCTION.......... 39
4.2 THE DOUBLE TAX RELIEF MECHANISMS AVAILABLE TO A SOUTH AFRICAN RESIDENT.. 40
4.2.1 Section 6quat of the Income Tax Act.......... 40
4.2.2 Section 10(1)(o) of the Income Tax Act.......... 43
4.3 DEFINITIONS RELATING TO THE APPLICATION OF SECTION 10(1)(O) OF THE INCOME TAX ACT 48
4.3.1 Employer.......... 48
4.3.2 Employee.......... 48
4.3.3 Remuneration.......... 49
4.4 INDEPENDENT CONTRACTORS.......... 51
4.5 CONCLUSION.......... 56

CHAPTER 5: EFFECT OF THE AMENDMENTS TO SECTION 10(1)(O)(II) OF THE INCOME TAX ACT.......... 59

5.1 INTRODUCTION 59
5.2 PROPOSED AMENDMENTS TO SECTION 10(1)(O)(II) OF THE INCOME TAX ACT 60
5.3 ARGUMENTS AGAINST THE REPEAL OF SECTION 10(1)(O)(II) OF THE INCOME TAX ACT 62
5.3.1 The tax will have a severely negative impact on finances and remittances to South Africa, especially on lower incomes 63
5.3.2 The cost of living in foreign countries is higher than in South Africa 63
5.3.3 Individuals made the decision to work and live abroad based on current tax treatment 64
5.3.4 The amendment is unduly harsh and sets South Africa apart from other countries 64
5.3.5 The proposal will lead to an acceleration of formal emigration from South Africa 64
5.3.6 The proposal will lead to an accelerated breaking of South Africa tax residence 65
5.3.7 The proposal increases the cost of employment of South African residents working abroad 65
5.3.8 The foreign tax credit may only be claimed on assessment 66
5.3.9 There are very long delays in processing and allowing foreign tax credits 66
5.3.10 Amendments are required to be made to section 6quat of the Income Tax Act 66
5.3.11 The draft legislation goes further than the proposal in Annexure C of the 2017 Budget Review 67
5.3.12 It is unfair to impose taxes on people who are not present in South Africa to enjoy the benefits of public expenditure 67
5.4 THE TAXATION LAWS AMENDMENT BILL, 2017 68
5.4.1 The R1 million exemption limit 69
5.5 CONCLUSION 72

CHAPTER 6: AUSTRALIA, UNITED KINGDOM AND UNITED STATES OF AMERICA: THE TAX PRINCIPLES OF RESIDENCY AND FOREIGN EMPLOYMENT INCOME RELIEF 73

6.1 INTRODUCTION 73
6.2 AUSTRALIA 73
6.2.1 Double Tax Agreements 73
6.2.2 Foreign income tax offset 74
6.3 UNITED KINGDOM 75
6.3.1 Foreign income exemption 76
6.3.2 Double Tax Agreement 76
6.3.3 Remittance basis of taxation 76
6.3.4 Exemption for small amounts of foreign income 77
6.3.5 PAY-AS-YOU-EARN guidance 77
6.4 UNITED STATES OF AMERICA 78
6.4.1 Foreign income exclusion, foreign housing exclusion and foreign housing deduction 79
6.5 CONCLUSION 82

CHAPTER 7: CONCLUSION 86

7.1 INTRODUCTION 86
7.2 SUMMARY OF CONCLUSIONS 86
7.3 FINAL CONCLUSION 90

REFERENCE LIST 92

CHAPTER 1: INTRODUCTION

1.1 RESEARCH CONTEXT

The amendment of the "gross income" definition in section 1 of the Income Tax Act, No. 58 of 1962 ("the Income Tax Act"), brought about the change from a source-based system of taxation to a residence-based system for South Africa for the years of assessment commencing on or after 1 January 2001. In terms of the residence-based system of taxation, a resident, as defined in section 1 of the Income Tax Act, will be taxed on receipts and accruals on a world-wide basis. In other words, irrespective of the source of the income, any income received by a South African resident is included in such resident's "gross income" as defined.

In recent years many companies have extended their operations and are trading in international markets. In a study by Movehub (2016:28), it was stated that "the global nature of business has created a society which is far less rooted to its location and a new generation which sees distance as no impediment". The English Oxford Living Dictionaries (Oxford Dictionaries: online) defines "globalisation" as "the process by which businesses or other organizations develop international influence or start operating on an international scale."

These changes and the rate at which companies are expanding their operations and requiring their employees to render services abroad, has resulted in the need for companies to carefully consider the tax implications for both their employees and for themselves. In addition, individuals have often elected to render services abroad in order to further their development or progress in their careers.

The adoption of the residence-based system of taxation has had an impact on South African residents, especially those residents who render services outside of South Africa. In such instances a resident may be subject to tax in both the foreign country in which the services are rendered as well as South Africa, due to the person being ordinarily resident in South Africa. Clegg (2017:2.3) explains that:

> Where a South African resident renders services abroad for a substantial period of time for a South African employer, government policy recognizes that it would often be inappropriate and counter-productive to South African businesses' competitiveness, to tax employees at South African tax rates for work done in the other country.

Section 10(1)(o) of the Income Tax Act presently exempts from normal tax:

(o) any form of remuneration –

(i) as defined in paragraph 1 of the Fourth Schedule, derived by any person as an officer or crew member of a ship engaged-

(aa) in the international transportation for reward of passengers of goods; or

(bb) in the prospecting, exploration or mining (including surveys and other work of a similar nature) for, or production of, any minerals (including natural oils) from the seabed outside the Republic, where such officer or crew member is employed on board such ship solely for the purposes of the "passage" of such ship, as defined in the Marine Traffic Act, 1981 (Act No. 2 of 1981),if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment;

(iA) as defined in paragraph 1 of the Fourth Schedule, derived by any person as an officer or crew member of a South African ship as defined in section 12Q(1) mainly engaged-

(aa) in international shipping as defined in section 12Q(1); or

(bb) in fishing outside the Republic; or

(ii) received by or accrued to any person employee during any year of assessment by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, including any amount referred to in paragraph (i) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C in respect of services rendered outside the Republic by that employee for or on behalf of any employer, if that employee was outside the Republic -

(aa) for a period or periods exceeding 183 full days in aggregate during any period of 12 months; and

(bb) for a continuous period exceeding 60 full days during that period of 12 months, and those services were rendered during that period or periods.

Therefore, section 10(1)(o) of the Income Tax Act offers individuals income tax relief when rendering services abroad. Section 10(1)(o)(ii), however, enables a South African resident, who works abroad and meets all the requirements of the section, to obtain the benefit of double non-taxation. Where such resident is working in a country where no foreign tax is payable, for

example working in Dubai, provided the requirements of section 10(1)(o)(ii) are met, such resident would not be subject to tax in South Africa, thus granting a resident the benefit of tax-free income.

Santana (2017:1) reports that, during the Budget Speech in February 2017, the Honourable Pravin Gordhan, the South African Finance Minister at the time, announced that: "in terms of the principle of base erosion and profit sharing, there are countries with hybrid mismatches. South African law has measures to limit double deductions and income exclusions where there is no corresponding deduction and deductions with no inclusions." One of these measures was the implementation of the foreign employment tax exemption. Minister Pravin Gordhan, therefore raised the concern that this measure may be seen as excessively generous and may need amendment.

On 19 July 2017, National Treasury released the Draft Taxation Laws Amendment Bill, 2017 for public comment. The draft proposed that section 10(1)(o)(ii) of the Income Tax Act be repealed in its entirety. The amendment was highlighted as one of the more controversial of the proposed amendments to the Income Tax Act and has raised concerns for employers. Visser (2017) states that some of the concerns raised are whether the cost of the tax burden will be borne by employers, how this will affect their bottom line, the compliance burden involved, as well as the additional costs that an employer may incur in requiring their employees to render services abroad. Visser (2017:2) states further that: "Particular concerns are possible retrenchments, the continued competitiveness of South African business in the continent, and of South Africa as the 'Gateway to Africa'." A repeal of section 10(1)(o) of the Income Tax Act will result in unbudgeted increased labour costs and additional administrative obligations for employers, that could result in possible retrenchments in an attempt to reduce costs. Hourigan (2017:1) illustrates these concerns further where he states that:

> any repeal of the exemption will likely result in employers in the private sector facing significant difficulties in mobilising their employee workforce to work on foreign based projects. This could result in significant loss of revenue for such employers. At the very least, it could result in unbudgeted increased labour costs and additional administrative obligations for these employers.

It is evident that the proposed amendment created uncertainty for both employers and employees and that the impact of the proposed amendment had not been fully considered. In light of the uncertainty and the concern that emerged as a result of the Draft Taxation Laws Amendment Bill

2017, National Treasury engaged in discussions to address the concerns. On the 18 December 2017, The Taxation Laws Amendment Bill was promulgated and introduced a R1 million exemption limit (applicable from years of assessment commencing on or after 1 March 2020).

Despite the introduction of the exemption limit, employers will need to consider whether the effect of the amendment would result in additional costs to the company and how this will affect their profit, as they may be faced with increased costs. Therefore, there is a need for clarity, to fully understand the impact that such amendment will have on those who are required to render services abroad and the effect on companies. In this regard, the tax consequences of individuals working abroad will be considered in this thesis.

The relevant legislation in the United Kingdom (UK), Australia and United States of America (US) will be also analysed in order to illustrate how these countries treat foreign employment income for tax purposes. This will assist in highlighting areas of similarity and demonstrate how these issues are dealt with in these countries. The choice of countries is based on the common law system that South African law, as well as Australian law, inherited from British law, as well as the manner in which these countries treat foreign employment income.

In each of these countries, individuals are required to declare all income, including foreign income, in their annual tax returns and subject the amounts to tax, despite the amount also being taxed in a foreign country. The countries have adopted mechanisms to deal with the issue of "double taxation" and as a result, these measures may assist in identifying possible mechanisms for South Africa to consider in light of the amendment to the treatment of foreign employment income.

1.2 GOALS OF THE RESEARCH

The main goal of the research is to highlight the tax consequences and exemptions available to resident individuals who perform services abroad. In this regard, consideration will be given to the impact the amendment to section 10(1)(o)(ii) of the Income Tax Act will have on individuals working abroad and on companies that employ them and highlight key factors that need to be considered when an individual elects to work abroad or when an employer requires an individual to work abroad.

In addressing the main goal of the research, the sub-goals are as follows:

- to highlight key factors that need to be considered when an individual elects to work abroad, or when an employer requires an individual to work abroad;
- to set out the relief mechanism and exemptions available to South African residents, distinguishing between independent contractors and employees;
- to discuss the impact of Double Tax Treaties, in the context of the OECD Model Tax Treaty;
- to discuss section 10(1)(o) of the Income Tax Act in its present form and its purpose;
- to explain the effect that the proposed changes to section 10(1)(o)(ii) of the Income Tax Act will have on resident individuals and companies that employ them; and
- to analyse the tax principles applying in the UK, Australia and US to deal with "double taxation", where residents are employed in foreign jurisdictions.

1.3 METHODS, PROCEDURES AND TECHNIQUES

In order to address the research question, an analysis and interpretation of the relevant legislation and case law will be undertaken. Commentary and articles from various tax experts will also be discussed.

In this regard the research method that will be adopted when conducting the research will be a legal interpretive approach; more specifically a doctrinal research methodology will be applied. This methodology provides a systematic exposition of the rules governing a particular legal category (in the present case the legal rules relating to the taxation of foreign employment income), analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2014).

The legal research will entail a literature survey and will rely on an interpretation of tax legislation. It will be conducted in the form of an extended natural language argument, supported by documentary evidence. The research will therefore entail an analysis of documentary data.

The validity and reliability of the research and the conclusions will be ensured by:

- adhering to the rules of the statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent, or which is of persuasive value, and the writings of acknowledged experts in the field;

- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

1.4 ETHICAL CONSIDERATIONS

The research will be based purely on a literature survey. As all the data will be publicly available, no ethical considerations arise in relation to their use. All opinions will be considered in their written form.

The researcher will not exaggerate or filter the data or results to support a particular viewpoint. Content will not be withheld or toned down. All sources of data will be appropriately acknowledged, and full references provided.

1.5 OVERVIEW

A residence-based system of taxation means that a person is subject to tax on all receipts and accruals regardless of the source of the income. The introduction of the residence-based system in South Africa resulted in a situation where individuals, who rendered services abroad, are subject to tax in both South Africa and the foreign country.

Chapter 2 commences with an analysis of the definition of "resident" and establishes that the key principle in determining the tax liability of a natural person and, consequently, the relief mechanisms which may apply in the event of double taxation, is to determine the "residence" of that person. The Chapter explains the taxes imposed on a South African resident and briefly explains how normal tax is collected in respect of a natural person. The chapter introduces the concept of double taxation and the two types of double taxation which arise.

Chapter 3 sets out the definition of juridical double taxation. The chapter discusses the purpose of Double Tax Agreements (DTAs) and how conflicts regarding the right of jurisdictions to tax income are resolved in terms of a DTA. The chapter also introduces the domestic law relief mechanisms available to a South African resident.

Chapter 4 provides an overview of the double tax relief mechanisms available to a South African resident. The chapter commences with a discussion of the section 6*quat* credit or deduction method of relief. It then sets out the foreign employment exemption in terms of section 10(1)(o) of the Income Tax Act and establishes the requirements which must be met in order for a person

to utilise the exemption. The chapter discusses the categories of persons to whom the exemption may apply and the important definitions that are relevant to the application of the exemption, including the definition of "remuneration". The Chapter notes that the definition of "remuneration" specifically excludes payments made to independent contractors and explains the distinction between an employee and an independent contractor.

Chapter 5 provides a discussion of the proposed amendments to section 10(1)(o)(ii) of the Income Tax Act and sets out the arguments against the repeal of the exemption. The chapter then discusses the final amendments in terms of the Taxation Laws Amendment Bill, promulgated on the 18 December 2017 and concludes with a commentary in respect of the amendment.

Chapter 6 discusses the relevant legislation of Australia, the UK and the US. The Chapter explains how each country determines an individual's tax liability. This is followed by an explanation of the foreign income exemptions offered to individuals in receipt of foreign employment income. The chapter concludes by illustrating similarities between Australia, the UK, the US and South Africa.

Chapter 7 provides a summary of the key findings in each chapter. The chapter explains the research goal addressed in each chapter and the conclusions reached. It follows with a discussion of factors that will need to be considered in light of the amendment to section 10(1)(o)(ii) of the Income Tax Act.

CHAPTER 2: ESTABLISHING THE TAX “RESIDENCE” OF A NATURAL PERSON

2.1 INTRODUCTION

The effect of globalisation and South Africa’s integration into the world economy has not only resulted in the cross-border flow of goods and services but also the movement of people internationally. The adoption of the worldwide basis of taxation in South Africa has resulted in both companies and individuals paying greater attention to the tax consequences, and ultimately their tax liability, when entering into service agreements to work abroad. The introduction of the residence-basis of taxation during 2001 brought with it the amendment to the definition of “gross income” to include the word “resident”. “Resident” has been defined in section 1 of the Income Tax Act, and where persons fall within the ambit of the definition of “resident” they will be subject to tax on their world-wide income, regardless of the source of that income. The key principle in determining the tax liability of an individual working abroad is therefore to determine the “residence” of that person. Avi-Yonah (2005) explained that a residence-based system of taxation is founded on the principle that individuals and companies should contribute towards the public services provided to them by the country in which they live, regardless of where the income is derived; source-based taxation is justified by the view that the country that provides the opportunity to generate the income should have a right to tax it. The authority for this distinction is the case of *Kergeulen Sealing and Whaling Co Ltd Appellant v Commissioner for Inland Revenue Respondent* 1939 AD 487, in which Stratford CJ stated (at 507) that:

> In some countries residence (or domicile) is made the test of liability for the reason, presumably, that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters him. In others (as in ours) the principle of liability adopted is "source of income" again presumably the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live. In both systems there is, of course, the assumption that the country adopting the one or the other has effective means to enforce the levy.

The residence-based system of taxation gave rise to greater tax implications for individuals, particularly those individuals who had opted to render services abroad and were already being subjected to tax in a foreign country. Individuals were therefore facing the situation where they were being subjected to tax in both the foreign country and in the Republic of South Africa.

The discussion in this chapter will relate primarily to the definition of “resident” and will illustrate why the determination of an individual’s residence status is necessary. Where a person has formally emigrated or where a person is deemed to be exclusively resident in another country for the purposes of the application of a DTA, that person will not be regarded as a resident in South Africa in terms of the definition of a “resident” in the Income Tax Act. It is therefore necessary to establish how an individual would qualify as a South African tax resident, in terms of the definition.

The goal of this chapter is to discuss the impact of South Africa’s change from a source-based system of taxation to a residence-based system of taxation. In doing so, the definition of a “resident” will be analysed. Chapter 2 seeks to answer two questions, (i) how do natural persons determine tax residency in South Africa? (ii) how does tax residence effect a person’s tax liability? Chapter 2 will assist in establishing the basis for chapter 3, which will discuss DTAs and illustrate the role DTAs play when South African residents render services abroad.

2.2 A SOURCE-BASED SYSTEM OF TAXATION

Historically, South Africa adopted a source-based system of taxation, which meant that tax was only levied on income whose “source” was deemed to be in South Africa in terms of the definition of “gross income” prior to its amendment. The source-based system of taxation applied equally to both individuals and companies, irrespective of whether the taxpayer was resident in South Africa. Non-residents were taxed on their South African sourced income at the same rate as residents and were entitled to the same deductions as residents. Williams (2009:9) stated that “under the source-based system, the Republic of South Africa had one of the world’s most favourable tax regimes for non-residents, giving the country the status of a quasi-tax haven.”

The source-based system of taxation was found to be inappropriate and, during the February 2000 Budget Review it was stated that “the source-based system of the Republic of South Africa had become increasingly out of line with international practice and inappropriate for the circumstances of the South African economy” (Williams, 2009:10). A briefing note issued by The South African Revenue Service (SARS) on 15 September 2000 (South African Revenue Service, 2000:1) identified the reasons for changing from the source-based system of taxation to a new residence-based system of taxation, namely:

- to place the income tax system on a sounder footing, thereby protecting the South African tax base from exploitation;
- to bring the South African tax system more in line with international tax principles;
- the relaxation of exchange control and the greater involvement of South African companies offshore; and
- to more effectively cater for the taxation of e-commerce.

In line with the announcement during the February 2000 Budget Review, the definition of "gross income" was amended and currently reads as follows in section 1 of the Income Tax Act:

> "Gross income", in relation to any year or period of assessment, means-
>
> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
>
> (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,
>
> during such year or period of assessment, excluding receipts and accruals of a capital nature …

The amendment to the definition of "gross income" resulted in the change from a source-based system of taxation to South Africa adopting a residence-based system of taxation. This meant that South African residents would be taxed on all receipts and accruals, whether derived from a South African source or any other source, save for receipts and accruals of a capital nature and any income specifically exempt in terms of section 10 of the of the Income Tax Act. Non-residents, however, remained taxable on their South African source income.

Based on the definition of "gross income" in terms of section 1 of the Income Tax Act, it is evident that a natural person's tax liability is dependent on whether he or she is a "resident", as defined in section 1 of the Income Tax Act. Where persons are resident in South Africa, all their income, regardless of source, will be taxable in South Africa. A person who is not resident in South Africa will be taxable only on income that has its source in South Africa. To determine whether an amount is from a source within South Africa, section 9 of the Income Tax Act provides that certain types of amount accrue from a source within the Republic of South Africa. Examples of such amounts include amounts which constitute dividends, interest as defined in section 24J of the Income Tax Act, royalties, amounts received or accrued in respect of the

imparting of any scientific, technical, industrial or commercial knowledge for use in the Republic of South Africa, amounts received or accrued in respect of the holding of a public office, or where the amounts received or accrued are in respect of services rendered to or work performed for any employer in the national, provincial or local sphere of government of the Republic of South Africa. In addition, the source principles established in case law will be applicable when determining the source of an amount that is not provided for in section 9 of the Income Tax Act.

2.3 RESIDENCE-BASED SYSTEM OF TAXATION

One of the changes to the definition of "gross income" was the inclusion and reference to the word "resident". De Koker and Williams (2017:1.8) state that:

> in South Africa, residence has been made the test of liability for income tax, presumably because a person who enjoys the legal, political and economic benefits of residence in South Africa, can justifiably be called on to contribute toward the cost of maintaining good order and the provision of various state funded services in the country that shelters him.

The residence-based system adopted in South Africa has been described as a "residence-minus" system, which means that residents will be taxed on their world-wide income, but certain categories of income and activities which are undertaken outside the Republic of South Africa will be exempt from tax. De Koker and Williams (2017) state that the change to this residence-based system was to bring the tax system into line with generally accepted norms for taxing international transactions. Therefore, the liability for tax is dependent upon either the place of residence of a person or, when dealing with non-residents, the source of the income.

In terms of section 1 of the Income Tax Act, "resident" means any –

(a) natural person who is-

(i) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic –

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that –

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a "port of entry" as contemplated in section 9(1) of the Immigration Act; 2002, or at any other place as may be permitted by the Director General of the Department of Home Affairs in terms of that Act.

(B) Where a person who is resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; …

In terms of the definition in section 1 of the Income Tax Act, natural persons will be resident if they are ordinarily resident in the Republic of South Africa or, if they are not ordinarily resident in the Republic of South Africa, if they were physically present in the Republic of South Africa for the periods prescribed above. To determine whether a natural person is a "resident" of the Republic of South Africa during a specific year of assessment, there are two tests that need to be considered. The first test entails an enquiry as to whether a person is ordinarily resident in the Republic of South Africa and the second is the physical presence test, which involves the application of specific statutory criteria. Each of these tests will be discussed below.

2.3.1 Ordinarily resident

The meaning of "ordinarily resident" is not defined in the Income Tax Act and South African Revenue Service, ("SARS") in Interpretation Note 3 (South African Revenue Service, 2002:4) states that the "question as to whether a person is ordinarily resident in a country is a question of fact and each case must be decided on its own facts having regard to the principles established by case law." Consideration must be given to the interpretation provided by the courts.

2.3.1.1 Cohen v Commissioner for Inland Revenue

In *Cohen v Commissioner for Inland Revenue,* 13 SATC 362, the taxpayer was assessed for super tax on certain dividends from public companies in respect of the year of assessment ending June 1942. The taxpayer was, throughout the whole of the year of assessment concerned, out of the Union and therefore appealed the assessment on the grounds that the dividends were exempt from super tax in terms of section 30(1)(a) of Act 31 of 1941, which stated that:

> there should be exempt from super tax (a) dividends, distributed by a public company, received by or accrued to or in favour of or apportioned in terms of paragraph (b) of section thirty-seven to an individual not ordinarily resident nor carrying on business in the Union.

Schreiner JA (at 365), referred to the case of *I.R.C. v Lysaght* (1928, A.c. 234 at p. 249) in which Lord Warrington of Clyfe stated:

> I have reluctantly come to the conclusion that it is now settled by authority that the question of residence or ordinary residence is one of degree, that there is no technical or special meaning attached to either expression for the purpose of the Income Tax Act, and accordingly a decision of the Commissioners on the question is a finding of fact and cannot be reviewed unless it is made out to be based on some error in law, including the absence of evidence on which such a decision could properly be founded.

Although Schreiner JA deemed it unnecessary to express an opinion on the precise meaning to be given to the expression "ordinarily resident" he stated *obiter* (at 371) that:

> If though a man may be "resident" in more than one country at a time, he can only be "ordinarily resident" in one, it would be natural to interpret "ordinarily" by reference to the country of his most fixed or settled residence. This might not be his country of domicil, for it might not be his domicil of origin and he might not have formed the fixed and settled intention, which "excludes all contemplation of any event on the occurrence of which the residence would cease", which is necessary to bring into existence a domicil of choice, referring to *Johnson v Johnson,* (1931, A.D. 391). But his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings, as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home. If this suggested meaning were given to "ordinarily" it would not, I think, be logically permissible to hold that a person could be "ordinarily resident" in more than one country at the same time.

2.3.1.2 Commissioner for Inland Revenue v Kuttel

In *Commissioner for Inland Revenue v Kuttel*, 54 SATC 298, the taxpayer had been assessed to income tax on interest and dividends earned by him in a period during which he contended that he had not been ordinarily resident in South Africa. On 29 July1983 the taxpayer and his wife emigrated to the United States where he established a home in Fort Lauderdale, Florida, joined a church, opened bank accounts, acquired an office, registered with social security and bought a car. During the period September 1983 to November 1985, the taxpayer made a total of nine visits to South Africa. The purpose of the visits was to attend to the continuing liquidation of the taxpayer's interests, to participate in yachting and boat-building activities and to attend to family matters. During the visits to Cape Town the taxpayer stayed in a house owned by a company of which he and his wife were the sole shareholders. The house was available at all times and at no time was the house let out to others. During 1985 renovations were effected to the house, and the taxpayer's reasoning was that he wished a portion of his South African capital to be invested in fixed property as a hedge against the falling value of the Rand in relation to the dollar. Furthermore, the taxpayer stated that had he not been prohibited by the South African exchange control regulations from taking all his assets out of the country he would have done so.

Goldstone JA held (at 304) "that a person may have more than one residence at any one time is clear. In the present case we are concerned with the words 'ordinarily resident'. That is something different and, in my opinion, narrower than just 'resident'."

In giving judgment, the court (at 305) referred to the following English cases:

R v Barnet London Borough Council: Ex parte Shah and Other Appeals [1982] 1 All ER 698 (CA), where Lord Denning MR (at 704c-d) said that "the natural and ordinary meaning of 'ordinarily resident' was "that the person must be habitually and normally and resident here, apart from temporary or occasional absences of long or short duration."

In *Shah v Barnet London Borough Council and Other Appeals* [1983] 1 All ER 226(HL) (at 234b-c), the House of Lords, on appeal, approved the natural and ordinary meaning of the words. Lord Scarman stated (at 234d-f): "… I agree with Lord Denning MR that in their natural and ordinary meaning of the words mean 'that the person must be habitually and normally resident here, apart from temporary or occasional absences of long or short duration' …".

After a consideration of the above Goldstone JA held (at 306) “If one applies that meaning to the words, there can be no doubt that at all relevant times the respondent was not ordinarily resident in the Republic of South Africa.” In reaching this decision Goldstone JA considered the facts of the case and noted that factors such as:

- the exchange control regulations, which precluded certain assets from being taken to the United States;
- the fact that the respondent and his family members became United State citizens as soon as they were able to;
- upon completion of their schooling the respondent’s children permanently joined the respondent in the United States;
- the respondent’s visits to South Africa were primarily for business purposes, and subsequently became less frequent and shorter in length over the years; and
- the fact that the respondent had sound financial reasons for retaining an interest in immovable property, namely the house in Cape Town, which he occupied when he visited Cape Town,

were all indicative that the respondent, at all relevant times, was not ordinarily resident in the Republic.

SARS Interpretation Note 3 (South African Revenue Service, 2002:4) states that:

> a person’s mode of life may be such that it cannot be said that he or she has a real home anywhere. A common feature of multinational corporations is that certain staff is virtually permanent wanderers. In such a case the burden would be on the taxpayer to discharge the onus that he/she is not ordinarily resident in the Republic.

Therefore, to be “ordinarily resident” in a country, physical presence at all times is not required. “Ordinarily resident”, in effect, has two distinct requirements, an intention to become ordinarily resident in a country and steps indicative of this intention having been or being carried out.

The above discussion, together with a consideration of the applicable case law, illustrates that the intention of a person is paramount when determining whether the person is ordinarily resident. The reason for this is that a person can be “ordinarily resident” in the Republic of South Africa despite the fact that he or she may not be physically present in the Republic of South Africa for the required number of days. It is therefore imperative that both the intention as well as the circumstances of a person are considered when determining whether the person is “ordinarily resident” in the Republic of South Africa.

2.3.2 Physical presence test

The second test is the physical presence test. It is subsidiary to the "ordinarily resident" test, meaning that this test is only applied where a person is not "ordinarily resident" in the Republic of South Africa. The physical presence test is based on the number of days that a natural person is physically present in the Republic of South Africa. The physical presence test should be applied on an annual basis.

De Koker and Williams (2017:5.2B) refer to the guiding principle of the physical presence test:

> A natural person who 'is not at any time during the relevant year of assessment ordinarily resident in the Republic' will nevertheless be regarded as a 'resident' if he complies with certain criteria concerning his physical presence in the Republic. But it must be noted that the formulation of the definition is such that the physical presence test concerns only a taxpayer *who not at any time* during the period covered by the test itself remains or becomes ordinarily resident in South Africa. If he does then he is taxable in the year in which he becomes ordinarily resident, even though he may become so resident only on the last day of the year of assessment. (Emphasis in the original)

As stated above, the "ordinarily resident" test supersedes the physical presence test and therefore the physical presence test will not be applicable during any year in which a person is ordinarily resident. A person who is not ordinarily resident during a year of assessment will be regarded as resident in that year if he or she was physically present in the Republic of South Africa for a period or periods as set out in paragraph (a)(ii)(aa) and (bb) of the definition of "resident" in section 1 of the Income Tax Act:

> (aa) for a period of periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding the year of assessment; and
>
> (aa) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment

SARS Interpretation Note 4 (South African Revenue Service, 2018:2) details how a person would calculate the number of days in South Africa and states that:

> under proviso (A) to the definition of a 'resident' a day includes a part of a day. A day begins at 00:00 and ends at 24:00. A person who arrives in the Republic at 23:55 would thus be regarded as being physically present in the Republic for one day, even though that

person was only present for five minutes of that day. For this reason, both the day of arrival and departure, as indicated in the persons passport, are included in the count of the number of days.

SARS Interpretation Note 4, (South African Revenue Service, 2018) explains that a natural person, who is not ordinarily resident in the Republic of South Africa, can, in terms of the physical presence test, only become a resident for tax purposes in the year after a period of five consecutive years of assessment during which the person is physically present in the Republic of South Africa for a qualifying period or periods. A person who satisfies the requirements of the physical presence test will be subject to tax in the Republic of South Africa on his or her worldwide income.

It is evident from the above discussion that the physical presence test is an alternative test to the "ordinarily resident" test and the two tests are mutually exclusive. The above tests indicate that establishing "residence" in South Africa is dependent on the circumstances of an individual and more importantly the intention of the person. Where it is established that a person is ordinarily resident in the Republic of South Africa, the mere fact that he or she spends time outside the Republic of South Africa will not affect his or her residence status. Therefore, an individual who, based on a consideration of the circumstances and whose intention is to return to the Republic of South Africa after his or her wanderings, will be "ordinarily resident" in the Republic of South Africa, and therefore subject to tax on his or her worldwide income.

2.4 TAXES IMPOSED IN SOUTH AFRICA

Once it is established that a person is tax resident in South Africa, it is necessary to consider the types of taxes that are imposed on a person. De Koker and Williams (2018:1.1) explain that South Africa imposes many types of taxes, such as normal tax, donations tax, withholding tax, and capital gains tax. Normal tax is defined in section 1 of the Income Tax Act to mean "income tax referred to in section 5(1)."

Section 5 of the Income Tax Act states that

(1) Subject to the provisions of the Fourth Schedule there shall be paid annually for the benefit of the National Revenue Fund, an income tax (in this Act referred to as the normal tax) in respect of the taxable income received by or accrued to or in favour of-

(a) ....

(b) ....

(c) any person (other than a company) during the year of assessment ending during the period of 12 months ending the last day of February each year; and

(d) any company during every financial year of such company.

In respect of natural persons, which is the focus of this thesis, normal tax is collected by way of employees’ tax and provisional tax payments, together with the final amount of tax assessed. It is therefore not necessary to discuss the additional taxes such as donations tax and capital gains tax.

Employees’ tax is a withholding tax, commonly known as PAYE (Pay-as-you-earn) and is deducted from the remuneration of an employee by an employer. Provisional tax is paid by a person who derives taxable income other than remuneration (de Koker & Williams, 2018). The requirement for an employer to withhold PAYE is set out in paragraph 2 of the Fourth Schedule to the Act. In terms of paragraph 2, the employer is required to pay the amount deducted to the Commissioner within seven days after the end of the month in which the PAYE was withheld. Paragraph 17 of the Fourth Schedule details the requirement of individuals to make their provisional tax payments to the Commissioner. De Koker and Williams (2018:1.2) explain that “provisional tax is paid by taxpayers deriving taxable income other than remuneration, for example, income from a business or profession.” All payments made in respect of a person’s PAYE or provisional tax are credited to the tax liability of that person, therefore reducing their overall liability at the end of a year of assessment.

The distinction between PAYE and provisional tax is important for the purposes of this thesis as the section 10(1)(o) of the Income Tax Act exemption relates specifically to a person in receipt of remuneration. Therefore, where an employer has an obligation to withhold PAYE in respect of an employee who is stationed outside South Africa, employers will need to ensure that they satisfy themselves as to the tax residency of the employee as well as whether the provisions of section 10(1)(o) apply. It is important to note that the obligation to withhold PAYE correctly rests on the employer, therefore any under-payment or under-declaration of PAYE by an employer may result in SARS seeking recourse against the employer. This is particularly important when sending employees on long term assignments, as while an employer may intend that an assignment meet the requirements of section 10(1)(o), the assignment may change and where the employer has not withheld the required PAYE, the employer will be liable to SARS for the under-payment of PAYE, together with interest and penalties (de Koker & Williams, 2018). It is evident that this may lead to double taxation, as employers may adopt a cautious

approach and withhold PAYE, despite the application of an exemption. Furthermore, different countries levy tax in different ways, resulting in double taxation due to the same income being subject to tax in both countries.

2.5 DOUBLE TAXATION

De Koker (2018:1.4) explains that double taxation arises where an amount of income is subject to tax in more than one state as a result of the states imposing tax on an amount on different but overlapping jurisdictional bases. The author explains further that there are two types of double taxation, juridical double taxation and economic double taxation. De Koker (2018:1.4) explains that juridical double taxation "is usually the result of two or more fiscal jurisdictions claiming taxing rights in respect of the same subject-matter for the same period…". Similar taxes are therefore imposed by the fiscal jurisdictions in respect of the same taxpayer, the same income and the same time period.

Economic double taxation, as explained by de Koker (2018:1.4), "occurs where more than one person is taxed on the same object of taxation." This arises where the same income is subjected to tax in the hands of different taxpayers. De Koker (2018:1.4) explains that "economic double taxation may be the result, not of a conflict, but of a mere inconsistency in the domestic laws of different fiscal jurisdictions."

The distinction between economic double taxation and juridical double taxation is relevant for the purposes of this thesis as the thesis focuses on individuals who may be liable for tax in more than one jurisdiction, in respect of the same income.

As stated above, relief from double taxation is granted in terms of a tax treaty or by domestic law. In addition, where a person is deemed to be resident of another country for the purposes of a Double Tax Agreement ("DTA"), that person will not be regarded as a resident in South Africa. This will be discussed further in Chapter 3.

2.6 CONCLUSION

Based on the above discussion, it is evident that South Africa's source-based system of taxation provided opportunities for the exploitation of the South African tax base. The introduction of the residence-based system in South Africa was therefore welcomed as it ensured that South Africa could align itself with international tax principles. The amendments to the Income Tax Act consequent upon the introduction of a residence-based system of taxation included the insertion

of the definition of the word “resident” into section 1 of the Income Tax Act. The Income Tax Act defines a “resident” as a natural person who is ordinarily resident in the Republic of South Africa, or a non-resident who has been physically present in South Africa for a specific period.

This chapter sought to answer two questions. The first question focused on how natural persons determine tax residency. As stated above, the Income Tax Act defines “resident” and refers to a person who is “ordinarily resident” or a non-resident who is physically present in South Africa for a specified period. The term “ordinarily resident” is not defined in the Income Tax Act, however, the courts have provided guidance on the factors to consider when establishing whether a natural person is ordinarily resident in the Republic of South Africa. In this chapter the decision in the case of *Cohen v Commissioner for Inland Revenue* was referred to, and in this case the court stated *obiter* that a person may be resident in more than one place, but only “ordinarily resident” in one place. A person would be ordinarily resident in the place to which he or she naturally returned from his or her wanderings. The case of *Commissioner for Inland Revenue v Kuttel* was also cited and this decision confirmed that a person may have more than one residence, but that “ordinarily resident” meant something more and one had to closely consider the facts of each case. SARS Interpretation Note 3 (South African Revenue Service, 2002) adopted a similar approach and explained that one needs to look at the intention of the person and whether the person had the intention to become “ordinarily resident” in the Republic of South Africa. Therefore, when determining whether a person is “ordinarily resident” in the Republic of South Africa, case law principles must apply. It is crucial that both the intention of the person as well as their actions are considered in reaching a conclusion. Where it cannot be established that a person is “ordinarily resident”, the second test becomes relevant. This second test, the physical presence test, relates to the number of days a person is in or out of the Republic of South Africa. Therefore, where a person is not “ordinarily resident” the physical presence test may result in the person being a “resident” due to the number of days spent in the Republic of South Africa. However, where a person is “ordinarily resident” the mere fact that he or she may be outside the Republic of South Africa does not change their residence status if it is proved, on a consideration of all facts, that, he or she intends to return to the Republic of South Africa after his or her wanderings.

This leads to the second question, which relates to the effect that residence has on a person’s tax liability. Where it is established that a person is “resident” in South Africa, that person is subject to tax on all his or her income, regardless of its source, including amounts received in respect of work abroad. This resulted in the situation where an individual was subjected to double taxation.

This negatively impacted many individuals, especially those who had taken up employment abroad. These individuals found themselves in a situation where they were subject to tax in both the foreign country and in South Africa. Section 10(1)(o) of the Income Tax Act, and particularly section 10(1)(o)(ii), was introduced to alleviate the risk of double taxation and assist individuals in planning their tax affairs when entering into employment contracts abroad.

This thesis focuses primarily on the section 10(1)(o) of the Income Tax Act exemption. Section 10(1)(o) only applies to a person who is a South African tax resident and any amendment to section (10)(1)(o) only affects a person who is a South African tax resident. It is therefore evident that the determination of a person's "residence" status is a key factor in determining the tax liability of a person and, to do so, the above-mentioned tests would need to be applied on a case by case basis, taking account of all the facts and circumstances of the individual.

CHAPTER 3: DOUBLE TAX AGREEMENTS

3.1 INTRODUCTION

Chapter 2 described the change from the source-based system of taxation to the residence-based system of taxation in South Africa. South African tax residents are taxable on their world-wide income irrespective of the source of that income. Chapter 2 established that determining the "residence" of a natural person is essential in establishing the tax liability of the person. Chapter 2 continued to explain the tests used to determine the tax residency of a person and illustrated that the change to the residence-based system of taxation resulted in the situation where individuals, specifically those working abroad, could be subjected to tax in both the foreign country and South Africa in respect of the same income, resulting in double taxation. Honiball and Olivier (2011) explain that while the tax laws of different countries may be similar, they vary in important respects and it is these differences which lead to double taxation, or in some circumstances non-taxation or double non-taxation. Relief from double taxation may be provided under the domestic law or in terms of a tax treaty.

Honiball and Olivier (2011) explain that DTAs pay an important role in international tax and that Model Tax Conventions (MTCs) were created to ensure a degree of standardisation of the contents of DTAs. Honiball and Olivier (2011:269) state that: "a tax treaty lays down the boundaries within which domestic tax provisions are enforceable. In the absence of these rules, it would have been possible for each Contracting State to levy the maximum tax without any regard for the taxpayer's overall tax burden."

The authors explain that the best-known MTCs are those of the Organisation for Economic Co-Operation and Development (OECD) and to a lesser extent the United Nations (UN). The OECD MTC is based primarily on a tax system which uses the basic concept of residence rather than territory or source. Honiball and Olivier (2011) explain that the purpose of a treaty is to allocate taxing rights between the residence and source states and create an independent voice in order to avoid double taxation. Essentially, the treaties restrict the contracting states' taxing claims in instances where there could be an overlap. This is done by one of the states giving up its taxing rights, limiting the extent to which it levies tax or providing a tax credit. The tax treaty lays down the boundaries within which the domestic tax provisions are enforceable.

Hattingh (2018) explains that South Africa concluded its first double tax convention in 1939 with Southern Rhodesia. It was only in 1946, however, after the conclusion of a comprehensive

double tax convention with the UK, that a number of tax treaties were concluded. Unilateral relief for international double taxation was only introduced in South Africa during 1987. Hattingh (2018:36.2) continues to state that: “Today, South Africa has by far the largest tax treaty network on the African continent and compares favourably with most if not all of the tax treaty networks of her trading partners.”

Chapter 3 will discuss the role and objectives of DTAs and will explain how residency is determined from a Treaty perspective and the effect of a DTA on a South African tax resident in receipt of foreign employment income.

Chapter 3 will assist in establishing the basis for chapter 4, which will discuss the domestic law relief mechanisms and exemptions available to South African tax residents rendering services abroad to alleviate double taxation.

3.2 OBJECTIVE OF DOUBLE TAX AGREEMENTS

Clegg and Stretch (2019) explain that there are three objectives of a DTA: the avoidance of double taxation, the prevention of fiscal evasion and the exchange of information. This thesis focuses on the issue of double taxation only.

Chapter 2 explained that double taxation arises when an amount of income is subject to tax in more than one state. It highlighted the two types of double taxation, namely juridical and economic double taxation. For the purpose of this thesis the discussion relates to juridical double taxation.

Hattingh (2018) explains that juridical double taxation manifests itself in three ways.

(i) In residence/source conflicts. This occurs between the tax systems of two countries to which a taxpayer, activity or asset of the taxpayer bears a connection either through the source of income or the country in which the person is tax resident. Typically, this occurs where a residence country taxes a person on that person’s tax residence in the country, regardless of the source of the income, while the source country taxes the income based on the source of the income being located in that country. Therefore, this results in both countries taxing the same income of the same person.

(ii) In residence/residence conflicts. This occurs where two countries, during the same period, view a person as being tax resident in their country. This results in a person being taxed in both countries in respect of the same income. Hattingh (2018) explains

that residence/residence conflicts may arise as a result of countries adopting different criteria to determine the residence of a person, and thus the facts are interpreted differently in each of the countries.

(iii) In source/source conflicts. This occurs when two countries view a specific item of income as being earned or derived from a source within their territory.

Hattingh (2018) continues to explain that individual countries use various mechanisms to alleviate international juridical double taxation. The two most common methods are the foreign tax credit and the foreign income exemption. South Africa provides relief from both economic and juridical double taxation. The mechanisms used by South Africa are briefly mentioned below and are discussed in chapter 4.

Where domestic law fails to provide relief, or where a conflict arises as a result of residence, which is often the issue, a DTA will assist to provide mechanisms to resolve the conflict. When dealing with residence conflicts the DTA sets out a number of tests, commonly referred to as the "tie breaker" tests. This will be discussed in further detail below.

3.3 DOUBLE TAX AGREEMENTS AND THE CONSTITUTION

Section 2 of the Constitution of the Republic of South Africa, 1996 (the Constitution) provides that the Constitution is the "supreme law of the land". Under the heading "international law", the Constitution deals with international agreements in section 231, international customary agreements in section 232 and the application of international law in section 233. Honiball and Olivier (2011:303) state that "as a treaty is classified as an international agreement, it has to be applied in accordance with and in the context of section 231 of the Constitution. Section 108 of the Income Tax Act sets out the procedures for the recognition of tax treaties in South African Law."

Section 108 of the Income Tax Act states that:

> (1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.

(2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act.

(3) ……

(4) ……

(5) The duty imposed by any law to preserve secrecy with regard to such tax shall not prevent the disclosure to any authorized officer of the country contemplated in subsection (1), of the facts, knowledge of which is necessary to enable it to be determined whether immunity, exemption or relief ought to be given or which it is necessary to disclose in order to render or receive assistance in accordance with the arrangements noticed in terms of subsection (2).

It is evident from the above that once section 108(2) has been complied with, a tax treaty will have the same legal effect as any section in the Income Tax Act.

Hattingh (2018) discusses the importance of the constitutional status of South Africa's double tax conventions. The author explains that the constitutional status is relevant in determining who may invoke a tax treaty, it determines whether tax treaties have a direct effect, it determines the validity of domestic law enacted subsequent to the date of a treaty and whether the provisions of tax treaties may form the legal basis for the imposition of tax in the absence of an Act of Parliament. Hattingh (2018:36.14) submits that: "any derogation or an attempt to undermine an obligation arsing for the South African state under an operative double tax convention that has received the approval of Parliament would, in the scheme of things, be tantamount to unconstitutional behaviour."

3.4 APPLICATION OF DOUBLE TAX AGREEMENTS

Hattingh (2018) states that under the OECD and United Nations Model Tax Conventions, two methods to deal with double taxation are provided, the foreign income exemption and the foreign tax credit. The primary approach adopted by South Africa is the foreign tax credit method. The OECD is divided into seven chapters, chapter five deals specifically with double taxation. Article 1 deals with the application of a DTA. A DTA will only apply where the taxpayer is a person and is resident in one or both of the Contracting States. A person is defined in Article 3 and includes an individual, company and any other body of persons. The requirements in Article 1 of a DTA once again emphasise the importance of establishing the residency of a person.

Honiball and Olivier (2011:274) refer to Edwardes-Kerr Tax Treaty Interpretation (1994), Chapter 33, which indicates that:

> three steps should be followed to determine the relationship between a tax treaty and domestic law. Under step one, it should be determined whether a tax liability arises under domestic law. If no liability arises under domestic law, no need exists to apply the provisions of the treaty as no liability will arise. If domestic law does impose tax, step two is to determine whether under the tax treaty the relevant State has the right to impose tax. If the treaty does not award taxing rights to the Contracting State, tax may not be imposed despite the existence of taxing provisions in domestic law. If the treaty does allow taxing rights, then step three is to determine whether the treaty imposes any limitations on the States' right to tax, for example the imposition of a maximum tax rate.

The OECD Model Tax Convention on Income and Capital: Condensed Version (2017:105) provides commentary on Article 4 of the DTA which relates to the definition of resident and states that:

> The concept of "resident of a Contracting State" has various functions and is of importance in three cases:
>
> a) in determining a convention's personal scope of application;
> b) in solving cases where double taxation arises in consequence of double residence;
> c) in solving cases where double taxation arises as a consequence of double taxation in the State of residence and in the State of source or situs.

The purpose of Article 4 is to define the term "resident of a contracting state" in order to resolve conflicts in the situation where both contracting states deem a person to be resident in their country. Article 4 provides "tie-breaker" rules to determine which state should be granted the taxing rights. Article 4 of the OECD Model Tax Convention defines a "resident" as:

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where, by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

   a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
   b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
   c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
   d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relied or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The OECD Model Tax Convention on Income and Capital: Condensed Version (2017) explains that Paragraph 1 refers to the concept of residence as adopted in domestic law. The definition covers the various forms of personal attachment to a State, which results in a person being fully taxable in that State. It also considers whether a person is deemed to be resident in terms of the domestic laws of a State, resulting in that person being fully taxed in that State. A person will not be a "resident of a Contracting State", in respect of the Convention if "although not domiciled in that State, he is considered to be a resident according to domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State." (The OECD Model Tax Convention on Income and Capital: Condensed Version (2017:106)). Lewis (2019:17.5.2) explains that:

> the criteria for determining residence in art 4(1) involves more than simply being liable to

> taxation on some portion of income (source liability); they entail being subject to as comprehensive a tax liability as is imposed by a state. Therefore, where a person is not subject to as comprehensive a tax liability as is imposed in the state, that person will not be regarded as a 'resident' for purposes of the treaty.

Paragraph 2 of the OECD Model Tax Convention is applicable where an individual, in terms of Paragraph 1 is "resident" in both Contracting States. The conflict is resolved by the application of special rules which give one State preference over the other. The OECD Model Tax Convention on Income and Capital: Condensed Version (2017) explains that the facts to which the special rules apply, are those which relate only during the period when the residence of the person affects the tax liability of that person. The Article gives preference to the Contracting State in which the individual has a permanent home. When considering the concept of "home", permanence of the home is essential, which means the home should be available to the individual at all times. Should the individual have a home in both States, Paragraph 2 states that preference will be given to the State with which the individual has closer personal and economic relations, the individual's "centre of vital interest". Factors such as a person's family, social relations and place of business will be considered in order to establish in which State the individual will be said to have a permanent home. Subparagraph (b) of paragraph 2 addresses the situation where a person has two permanent homes and it cannot be established which home is "centre to his/her vital interests" or where the person has no permanent home. In this situation the Article gives preference to the Contracting State where the individual has an habitual abode.

Lewis (2010) considered the case of *Pamela Allchin v Her Majesty the Queen* 2000-2642 (IT) G. Ms Allchin was born in Canada and moved to Detroit, Michigan (USA) in 1967. She had obtained a green card status through employment and was registered as a nurse. Ms Allchin's green card was renewed every six months by virtue of occasional employment in Detroit, commuting from Windsor (Canada) to work day-shifts. During 1991, Ms Allchin resigned from the Windsor hospital and decided to seek full time employment in the USA. Throughout the disputed years, Ms Allchin worked in the hospital industry selling hospital supplies throughout the USA. At the time of judgment, Ms Allchin had resigned and was living in Windsor. The issue in this case was whether Ms Allchin, in her 1993, 1994 and 1995 taxation years, was resident in Canada, and taxable in Canada.

The court, in considering Ms Allchin's "permanent home", held that the factors indicated that it was possible to have a permanent home in both the USA and Canada. The court therefore had to

consider the second test in Article 4(2), namely the question of Ms Allchin's "centre of vital interests". The court again considered all the facts and circumstances and held that Ms Allchin had her "centre of vital interests" in both Canada and USA. The Court had to determine Ms Allchin's place of "habitual abode". In doing so Bell J (at 52) referred to:

> The New Shorter Oxford English Dictionary which describes "abode" as inter alia, "a habitual residence". It describes "habitual" as:
>
> Of nature of habits fixed by habit; constantly repeated or continued.
>
> . . . Given to a specified habit; that habitually does or is what is denoted by the noun . . . usual, constant, continual.'

The court considered the number of days actually spent by Ms Allchin in both the USA and Canada and held that on a consideration of all the evidence, the nature of Ms Allchin's lifestyle and activities in the USA indicated that her habitual abode was the USA. The court held that, in terms of Article 4(2)(b) of the Treaty, Ms Allchin was deemed to be a resident of the Contracting State in which she had an habitual abode, in this case the USA.

The main purpose of the OECD Model Tax Convention on Income and Capital: Condensed Version (2017:9) is to provide a "means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation". This ensures that any obstacles that double taxation presents to the development of economic relations between countries are removed. Therefore, when determining the tax liability of a South African resident who receives income from outside of South Africa, one needs to take into consideration whether a DTA applies.

Paragraph 19 of the OECD Model Tax Convention on Income and Capital (2014) establishes two categories of rules. The first relates to the rights of the State of Source to levy tax and the rights of the State of Residence in respect of certain classes of income, as set out in Articles 6 to 21, and Capital in Article 22. The second rule requires that, to the extent that these provisions confer on the State of Source a full or a limited right to tax, the State of Residence must provide relief so as to avoid double taxation. In addition, the Articles confer exclusive taxing rights on certain Contracting States in respect of certain classes of income or capital. By conferring exclusive rights on one Contracting State, these items are precluded from being taxed in the other Contracting State and in this manner double taxation is avoided. The general rule is that the exclusive right to tax is conferred on the State of Residence, but this is dependent on the nature

of the income or capital.

Article 15 of the OECD Model Tax Convention deals with the taxation of income from employment. In terms of the OECD Model Tax Convention on Income and Capital: Condensed Version (2017:305) paragraph 1 of Article 15, sets out the general rule in respect of the taxation of employment income, "that such income is taxable in the State where the employment is actually exercised." The commentary explains that

> one consequence of this would be that a resident of a Contracting State who derived remuneration, in respect of an employment, from sources in the other State could not be taxed in that other State in respect of that remuneration merely because the results of his work were exploited in that other State.

The commentary acknowledges that member countries have understood the term "salaries, wages and other similar remuneration" to include benefits in kind. Kruger and Scholtz (2013:150) state that the effect of DTAs is that where a resident of South Africa derives remuneration from employment in a foreign country, and a DTA exists between South Africa and that foreign country, the remuneration will only be taxable in South Africa if:

- the taxpayer is present in the other contracting state for a period or periods not exceeding 183 days in aggregate in the fiscal year concerned;
- his/her remuneration is paid by an employer who is not resident in the other contracting state; and
- his/her remuneration is not borne by a permanent establishment or a fixed base which his employer has in the other contracting state.

Where these requirements are not all present, the South African resident may be taxed in the foreign country. South Africa has a wide range of DTAs but does not have agreements with all countries. There may also be instances where a DTA does not apply and this may result in the income of the resident being taxable in both the foreign country and South Africa. The DTA has prescribed methods to assist in eliminating double taxation. In addition, SARS Interpretation Note 18 (South African Revenue Service, 2015) sets out the relief that South Africa provides to its residents in respect of double taxation and explains the different rebate methods available namely:

- *Section 6quat of the Income Tax Act*

This is the principal method that is used to provide for relief for foreign taxes that are proved to be payable on foreign income, but where the foreign income is also required to be included in the person's taxable income in South Africa. The Act allows for a rebate or a reduction in respect of the foreign taxes. This rebate is limited to the amount of local tax which is payable in respect of the foreign income.

- *Section 6quat(1C) of the Income Tax Act*

This is the method used to determine the taxable income of a resident from carrying on any trade. In terms of this section, the taxpayer, at the election of the resident, be allowed a deduction from the income of the resident, the sum of any taxes on income paid or proved to be payable by that resident to any country other than the Republic of South Africa.

- *Section 64N of the Income Tax Act*

Section 64N of the Income Tax Act provides relief from foreign taxes on foreign dividends paid to a resident by a foreign company listed on the Johannesburg Stock Exchange.

The rebate methods referred to above will be discussed further in Chapter 4.

3.5 CONCLUSION

The goal of this chapter was to set out the purpose of a DTA, establish how residency is determined in terms of a DTA and explain how a DTA affects a resident deriving foreign income. The chapter highlights that relief from double taxation may be provided under either the domestic law of a country or in terms of a tax treaty. The purpose of a DTA is to ensure that a person will not be subject to tax in more than one country, and in doing so allocates taxing rights between the countries. It is evident from the discussion that the issue of double taxation arises where there is a conflict due to the residency of an individual. Therefore, when allocating the taxing rights, a DTA sets out how residence should be determined. In terms of a DTA, residency is determined on a day-to-day basis, whereas for domestic law purposes residence is determined on an annual basis, thus resulting in the situation where a person may be resident in more than one State. The DTA therefore makes provision for a tie-breaker clause. Application of the tie-breaker clause requires the contracting states to consider the facts and circumstances of the individual. Furthermore, consideration must be given, specifically in respect of employment income, to the number of days an individual is present in the other state and the place where the services are rendered. The determination of residency on a day-to day basis, for the purposes of a DTA, may

therefore result in a person being resident in one State for a specific period and resident in the other State for the remaining period. However, it must be noted that where a DTA deems a person to be resident in a particular Contracting State or allocates the taxing rights to a particular State, that person will not be resident in the other State.

Chapter 4 will consider the South African domestic tax relief mechanisms mentioned above as well as the exemptions available to a tax resident. In doing so, consideration will be given to the definition of remuneration.

CHAPTER 4: OVERVIEW OF THE DOMESTIC DOUBLE TAX RELIEF MECHANISMS AVAILABLE TO A SOUTH AFRICAN TAX RESIDENT

4.1 INTRODUCTION

The discussions in chapters 2 and 3 illustrate that the residency of an individual is key to establishing an individual's tax liability. It is evident that conflicts regarding residence and source have resulted in the concept of juridical double taxation as each country has different rules in respect of the taxation of income and the determination of the residence of an individual. Chapter 3 explained that relief from double taxation may be provided under the domestic law of a country or in terms of a tax treaty. Chapter 3 set out the purpose of a DTA and explained that residency is defined for the purposes of a DTA and is determined on a day-to-day basis. In addition, a "tie-breaker" clause has been included in a DTA to assist in avoiding the situation where an individual is deemed to be a resident of two countries. Furthermore, chapter 3 explained that DTAs make specific reference to the taxation of income from employment and allocate the taxing rights to the State where the employment is exercised. In terms of the commentary on OECD Model Tax Convention member states acknowledge that remuneration includes benefits in kind. DTAs set out the requirements to be met where South Africa will retain the taxing rights on that remuneration, namely, where the taxpayer is in the other State for a period not exceeding 183 days, the remuneration is paid by an employer not resident in the other State and the remuneration is not borne by a permanent establishment or fixed base in the other contracting state. Where all these requirements are not met, the South African resident may be taxed in the other State.

Chapter 3 concluded that establishing a person's tax residency, while being the starting point in determining the personal tax liability of a person working abroad, is also relevant to the application of a DTA and the domestic law relief mechanisms available to an individual.

The domestic relief mechanisms highlighted in chapter 3 will form the basis of the discussion of this chapter. The chapter will also discuss the section 10(1)(o) exemption of the Income Tax Act provided to an individual in receipt of foreign employment income. The goal of the chapter is to discuss the relief mechanisms and exemptions available, with particular reference to section 10(1)(o)(ii). In doing so the chapter will discuss section 10(1)(o) in its present form, present its purpose, and establish the qualifying criteria for utilising the exemption. The chapter will consider the key definitions which are applicable to the application of the exemption and, in this

regard, a distinction will be drawn between an employee and an independent contractor rendering services abroad. Chapter 4 will seek to address the following:

(i) establish the relief mechanisms and exemptions available to South African residents in terms of the domestic law;
(ii) highlight the purpose of the section 10(1)(o) exemption of the Income Tax Act;
(iii) explain the distinction between an independent contractor and an employee;
(iv) set out the definition of remuneration; and
(v) consider the effects of a DTA and domestic law relief mechanisms and exemptions applying to individuals, differentiating between independent contractors and employees.

This chapter will form the basis for chapter 5, which will discuss the amendments to section 10(1)(o) of the Income Tax Act, specifically the section 10(1)(o)(ii) exemption, explain the effect that the amendments will have on both the company and resident individuals who qualify and utilise the exemption, and comment on the final amendment to the section.

4.2 THE DOUBLE TAX RELIEF MECHANISMS AVAILABLE TO A SOUTH AFRICAN RESIDENT

Chapter 3 explained that where a person is subject to double taxation, relief can be sought in terms of a DTA or domestic law. Therefore, where domestic law does not provide an exemption or relief in respect of double taxation, application of a DTA should be considered.

Haupt (2018:576) states that:

> … many double tax agreements have an 'elimination of double taxation' article that states that South Africa must allow foreign tax paid on the income arising in that foreign country as a credit against South African tax on that income. Some articles provide that this must be done in terms of South African tax law (section 6*quat*) and some do not. Where the credit is not made subject to South African law, the taxpayer has a choice between using section 6*quat* or just claiming a tax credit.

4.2.1 Section 6*quat* of the Income Tax Act

Section 6*quat* of the Income Tax Act is the first of the relief mechanisms and entitles a South African tax resident to a rebate or deduction in respect of foreign taxes on income.

Section 6*quat*(1) of the Income Tax Act states that:

(1) Subject to subsection (2), where the taxable income of any resident during a year of assessment includes-

(a) any income received by or accrued to such resident from any source outside the Republic; or

(b) any proportional amount contemplated in section 9D; or

(e) any taxable capital gain contemplated in section 26A, from a source outside the Republic; or

(f) any amount-

(i) contemplated in paragraph (a) or (b) which is received by or accrued to any other person and which is deemed to have been received by or accrued to such resident in terms of section 7;

(ii) of capital gain of any other person from a source outside the Republic and which is attributed to that resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule; or

(iii) contemplated in paragraphs (a), (b) or (e) which represents capital of a trust, and which is included in the income of that resident in terms of section 25B(2A) or taken into account in determining the aggregate capital gain or aggregate capital loss of that resident in terms of paragraph 80(3) of the Eighth Schedule,

in determining the normal tax payable in respect of that taxable income there must be deducted a rebate determined in accordance with this section.

In terms of s6*quat*(1), a rebate can be claimed where a tax resident is in receipt of income from a source outside the Republic of South Africa, any proportional amount as contemplated in section 9D of the Income Tax Act, or any taxable capital gain as contemplated in section 26A of the Income Tax Act, from a source outside the Republic of South Africa.

Section 6*quat* (1A) of the Income Tax Act goes further to state that the rebate that may be claimed must be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic of South Africa. Therefore, an individual will only be entitled to a rebate equal to the taxes paid in the foreign country. However, in terms of section 6*quat* (1B) the rebates permitted are limited depending on the type of income to which the rebate is attributable. Section 6*quat* (1B) states that

Notwithstanding the provisions of subsection (1A)-

(a) the rebate or rebates of any tax proved to be payable as contemplated in subsection (1A), shall not in aggregate exceed an amount which bears to the to the total normal tax payable the same ratio as the total taxable income attributable to the income, proportional amount, taxable capital gain or amount as the case may be, which is included as contemplated in subsection (1), bears to the total taxable income.

With effect 1 March 2018, a proviso has been added to section 6*quat*(1B) of the Income Tax Act which requires that when determining the amount of taxable income attributed to the income as set out in section 6*quat*(1), one needs to take into account any allowable deductions as contemplated in terms of section 11F of the Income Tax Act (retirement fund contributions) and section 18A (donations to public benefit organisations) of the Income Tax Act. These deductions will then be deemed to have been incurred proportionately in respect of the taxable income derived from sources within and outside the Republic of South Africa. Thus, section 6*quat*(1B) sets a limit on the foreign tax credit relief.

SARS Interpretation Note 18 (South African Revenue Service, 2015) explains that section 6*quat*(1) of the Income Tax Act is South Africa's primary mechanism for avoiding double taxation. Section 6*quat* provides a deduction of foreign taxes from normal tax otherwise payable. South Africa grants this relief unilaterally through domestic legislation. Through its many tax treaties with various countries, relief is available bilaterally. SARS Interpretation Note 18 (South African Revenue Service, 2015:10) explains further that "the application of the foreign tax rebate results in a foreign-source amount only being subject to normal tax when the foreign tax is less than the normal tax". Furthermore, a foreign tax liability can only be set off against a liability for normal tax. Haupt (2018:576) explains that "section 6*quat* is therefore (except where a DTA provides otherwise) the only provision for claiming relief for foreign tax paid on foreign source income and it only applies to South African tax residents".

As summarised by Haupt (2018), section 6*quat* of the Income Tax Act may only be utilised by a South African tax resident and the deduction is only claimable where the foreign tax relates to income that is included in the resident's income. Therefore, a person cannot claim a rebate where foreign tax is paid on income that is not taxable in South Africa. Where foreign tax paid is recoverable, in terms of a DTA, from a foreign revenue service, no section 6*quat* rebate can be claimed and the individual would need to claim the foreign tax directly from the foreign revenue service. However, there are instances where a DTA may override domestic law and require that

a rebate be given to an individual regardless of the source of the income. Typically, this occurs where a DTA deems the source of the income to be in the foreign country, despite the work being done in South Africa. This results in an individual being permitted to claim a rebate, notwithstanding that section 6*quat* does not grant a rebate for income arising from a South African source. As the focus of this thesis is foreign employment income, section 6*quat* will not be discussed in any further detail.

4.2.2 Section 10(1)(o) of the Income Tax Act

As discussed in chapter 2, one of the changes to the definition of "gross income" was the inclusion of and reference to the word "resident". Where a natural person meets the definition of "resident", all income derived by that person, regardless of its source, is included in the taxable income of that person. A person who rendered services outside the Republic of South Africa and who derived income from this employment faced the situation where he or she was being taxed in the foreign country and again in South Africa on the income. DTAs are entered into between countries to try to eliminate the risk of double taxation and, in addition, the Income Tax Act provides for a foreign tax credit in terms of section 6*quat* of the Income Tax Act when a person was subjected to double taxation irrespective of a DTA being in force or where there is no DTA. Despite these forms of relief being available, a need arose to introduce some form of exemption to alleviate the tax burden of persons who were rendering services abroad. Section 10(1)(o) of the Income Tax Act was introduced into the Act to assist in alleviating the tax burden even further and to reduce the administrative burden that individuals faced when attempting to claim a foreign tax credit.

Williams (2015:17) stated that:

> on a global basis, countries need to maintain orderly tax regimes to promote international trade, and there is a need for accepted rules and conventions limiting any one country's rights to tax its own citizens or residents operating or investing abroad, or the citizens or residents of other countries doing so in its own jurisdiction.

It is therefore evident that countries need to ensure that their tax systems allow for the allocation of taxing rights between the countries, particularly where a person renders services abroad. Up to 18 December 2017 section 10(1)(o) of the Income Tax Act exempted from normal tax:

> Any form of remuneration –

(i) as defined in paragraph 1 of the Fourth Schedule, derived by any person as an officer or crew member of a ship engaged –

(aa) in the international transportation for reward of passengers or goods; or

(bb) in the prospecting, exploration or mining (including surveys and other work of a similar nature) for, or production of, any minerals (including natural oils) from the seabed outside the Republic, where such officer or crew member is employed on board such ship solely for purposes of the "passage" of such ship, as defined in the Marine Traffic Act, 1981 (Act No. 2of 1981), if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment;

(iA) as defined in paragraph 1 of the Fourth Schedule, derived by any person as an officer or crew member of a South African ship as defined in section 12Q (1) mainly engaged–

(aa) in international shipping as defined in section 12Q (1); or

(bb) in fishing outside the Republic; or

(ii) received by or accrued to any employee during any year of assessment by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, including any amount referred to in paragraph (i) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C in respect of services rendered outside the Republic by that employee for or on behalf of any employer, if that employee was outside the Republic –

It is evident from the above definition that section 10(1)(o) of the Income Tax Act provides an exemption in respect of three categories of persons. The first two categories provide an exemption for an officer or crew member of a ship and the third provides an exemption for any employee who is required to render services outside of South Africa and who meet the additional requirements of the section. Each of these categories will be discussed briefly below.

4.2.2.1 Section 10(1)(o)(i) of the Income Tax Act

Section 10(1)(o)(i) of the Income Tax Act provides an exemption from normal tax in two instances. Firstly, in terms of section 10(1)(o)(i)(aa) applies to officers or crew members of a ship who are outside the Republic for a period or periods exceeding 183 days during a year of

assessment. SARS Interpretation Note 34 (Issue 2) (South African Revenue Service, 2017) explains that in order to qualify for the exemption, a taxpayer must derive "remuneration", as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act, in respect of services rendered by way of employment, on a ship engaged in certain activities, outside the Republic during specified qualifying periods. SARS Interpretation Note 34 (Issue 2) (South African Revenue Service, 2017) explains further that the person must be a "resident" and must be an employee. It is evident that one of the requirements to qualify for the exemption is that the ship must be engaged in international transportation of passengers or goods for reward. SARS Interpretation Note 34 (Issue2) (South African Revenue Service, 2017:3) explains that this would refer to "merchant ships such as cruise ships, passenger liners and cargo ships travelling in international waters".

Secondly, in terms of section 10(1)(o)(i)(bb) of the Income Tax Act, ships engaged in prospecting, exploration, mining or the production of any minerals from the seabed outside South Africa, would also qualify for the exemption, but this is limited to officers and crew members who are employed on the ship, solely for the purposes of passage. Interpretation Note 34 (Issue2) South African Revenue Service, 2017:3) explains that "passage" in this context means the "navigation of the ship in a continuous, speedy and efficient manner. The exemption will therefore not apply to officers or crew members involved in the prospecting, exploration, mining or production activities of the ship."

4.2.2.2 Section 10(1)(o)(iA) of the Income Tax Act

SARS Interpretation Note 96 (South African Revenue Service, 2017) explains that section 10(1)(o)(iA) of the Income Tax Act was introduced into the Act in April 2014 as a result of the introduction of section 12Q. Section 12Q was introduced to provide tax relief for South African shipping companies. This resulted in the introduction of section 10(1)(o)(iA), which exempts any remuneration received by or accrued to any officer or crew member of a ship, which is mainly engaged in international shipping or fishing outside the Republic of South Africa, regardless of the period or periods spent outside the Republic of South Africa.

In terms of section 10(1)(o)(iA) of the Income Tax Act the exemption can be applied in two circumstances. The first is where the ship is engaged mainly in international shipping. This is an important requirement for the application of the exemption. "International shipping" as defined in section 12Q(1) means "the conveyance for compensation of passengers or goods by means of

the operation of a South African ship mainly engaged in international traffic.” SARS Interpretation Note 96 (South African Revenue Service, 2017:4) explains that “international traffic” is not defined in the Income Tax Act and must therefore be given its ordinary meaning and therefore defines “international traffic” as “the movement of a ship between the Republic of South Africa and a foreign nation, or between two foreign nations, or between ports in a foreign nation.” Therefore, passenger ships that do not transport passengers from one port to another would not qualify as operating in “international traffic” in instances where they leave from a port in the Republic and return to a port in the Republic of South Africa Interpretation Note 96 (South African Revenue Service, 2017:4).

The second manner in which the exemption can be applied is where the ship is “mainly” engaged for the purposes of fishing outside the Republic of South Africa. The exemption may be applied to any officer or crew member and is not limited to a specific activity of the individual. The activity of the ship is the deciding factor, i.e. “mainly fishing outside the Republic”. SARS Interpretation Note 96 (South African Revenue Service, 2017) explains that “mainly” for the purposes of section 10(1)(o)(iA) of the Income Tax Act is a quantitative measure of more than 50%.

It should be noted that the application of the exemption in terms of section 10(1)(o)(iA) of the Income Tax Act is not dependent on the number of days an individual is outside the Republic of South Africa. SARS Interpretation Note 96 (South African Revenue Service, 2017:7) highlights that “the test is simply whether the ship is mainly engaged in the activity outside the Republic of South Africa, and the employee derives remuneration from services rendered aboard that ship.”

4.2.2.3 Section 10(1)(o)(ii) of the Income Tax Act

Section 10(1)(o)(ii) of the Income Tax Act exempts any remuneration received by an employee who renders services outside South Africa. The exemption is based on two requirements, the first is that the person concerned must be physically outside of South Africa for more than 183 days in a 12-month period. This 12-month period does not need to fall within one year of assessment, but a 12-month period from the date of departure. The second requirement is that the person must be outside South Africa for 60 full days within the respective 12-month period. The 60 full-day requirement must be for a continuous period and therefore where a person returns to South Africa within the 60-day period, he or she will not qualify for the exemption. Furthermore, the exemption only applies to services rendered outside South Africa. A person cannot remain in

South Africa and render services for a foreign entity and qualify for the exemption. Any income derived in such a manner will be South African source income and will be taxable in the hands of that person.

When section 10(1)(o)(ii) of the Income Tax Act was originally introduced, counting the days was considered. SARS released SARS Interpretation Note 16 (South African Revenue Services, 2003:5), stating that weekends, public holidays, annual leave days, sick leave days and rest periods spent outside South Africa are taken into account when counting the number of days required for the exemption to apply. Where the exemption applied, all remuneration received by an individual, both from the foreign source while the employee was abroad and from the South African employment, during the qualifying 12-month period, was exempt, in terms of section 10(1)(o)(ii).

SARS Interpretation Note 16 (Issue 2) (South African Revenue Service, 2017:6), was then published and stated that "the remuneration that is exempted by this provision relates to amounts earned from services rendered outside the Republic of South Africa, if the days tests were met during any period of 12 months". Although this was correct, in practice this was not being applied by employers. The amended Interpretation Note therefore introduced an apportionment calculation that resulted in a second step being applied to determine the actual remuneration that would qualify as an exemption. Therefore, in order to apply the exemption, the first step would be to determine whether the 183/60-day rule was applicable. This included all calendar days. The second "apportionment test" would then have to be applied. This test excludes any day not regarded as a workday. This resulted in only actual days during which services were rendered being taken into account. Therefore, workdays in South Africa would be subject to normal tax. This eliminated the risk of income derived in SA falling within the exemption in the situation where a person returned to SA, engaged in work and then left SA rather than being subject to normal tax as it rightly should have been (Cliffe Dekker Hofmeyr, 2016).

The introduction of section 10(1)(o)(ii) of the Income Tax Act illustrates that "government policy recognises that it would often be inappropriate and counter-productive for the competitiveness of South African businesses, to tax employees at South African tax rates for work done in the other country" (de Koker & Williams, 2017:2.3). The introduction of section 10(1)(o)(ii) therefore granted individuals a form of relief from double taxation, provided they met all the requirements of the section. Cliffe Dekker Hofmeyr (2016:1), in an article entitled *SARS looks to clear up misconceptions relating to tax exemption for foreign employment* income, explained

that "the exemption has been utilised quite successfully over the years, by individuals rendering services in a foreign jurisdiction and earning income in respect of those foreign services."

The discussion above noted that there are a number of requirements to be met before the exemption could be applied. It is therefore necessary to consider the definitions of each of these requirements.

4.3 DEFINITIONS RELATING TO THE APPLICATION OF SECTION 10(1)(o) OF THE INCOME TAX ACT

The application of an exemption in terms of section (10)(1)(o) of the Income Tax Act requires that the individual is "resident" in South Africa, and that the "remuneration" received must, firstly, meet the definition as set out in the Fourth Schedule to the Income Tax Act, and secondly, be derived as a result of rendering services to an employer. These terms are specifically defined in the Act and are discussed below. It should be noted that the definition of "resident" has been discussed in Chapter 2.

4.3.1 Employer

Paragraph 1 of the Fourth Schedule to the Act defines an employer as:

> any person (excluding any person not acting as a principal, but including any person acting in a fiduciary capacity or in his capacity as a trustee in an insolvent estate, an executor or an administrator of a benefit fund, pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund or any other fund) who pays or is liable to pay to any person any amount by way of remuneration, and any person responsible for the payment of any amount by way of remuneration to any person under the provisions of any law or out of public funds (including the funds of any provincial council or any administration or undertaking of the State) or out of funds voted by Parliament or a provincial council.

4.3.2 Employee

An employee is defined in paragraph 1 of the Fourth Schedule to the Act as:

> (a) Any person (other than a company) who receives any remuneration or to whom any remuneration accrues;
> (b) any person who receives any remuneration or to whom any remuneration accrues by reason of any services rendered by such person to or on behalf of a labour broker;

(c) any labour broker;
(d) any person or class or category of person whom the Minister of Finance by notice in the *Gazette* declares to be an employee for the purposes of this definition;
(e) any personal service provider

4.3.3 Remuneration

"Remuneration" is defined in paragraph 1 of the Fourth Schedule to the Income Tax Act. De Koker and Williams (2018:20.2) explain that the definition can be divided into three parts namely "the general definition, the extended definition, and the excluding part of the definition which exclude certain amounts."

The "general definition" of "remuneration" as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act means:

> any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered including…

The "extended definition" is set out in paragraphs (a) to (g) of the definition of "remuneration" and includes in the definition, any amounts received by or accrued to a person in respect of annuity payments, amounts received as a result of services rendered, including the receipt of any voluntary awards, any amounts received by way of restraint of trade payments, amounts in respect of the termination, relinquishment or cancellation of employment or office, retirement fund lump sum benefits, and the cash equivalent of the value of any benefits or advantages granted in respect of employment.

Paragraph (ii) of the definition deals with the exclusions from "remuneration", and specifically excludes:

> any amount paid or payable in respect of services rendered or to be rendered by any person (other than a person who is not a resident or an employee contemplated in paragraph (b), (c), (d) or (e) of the definition of "employee") in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered: Provided that for the purposes of this paragraph a person shall not be deemed to carry on a trade independently as aforesaid if the

> services are required to be performed mainly at the premises of the person by whom such amount is paid or payable or of the person to whom such services were or are to be rendered and the person who rendered or will render the services is subject to the control or supervision of any other person as to the manner in which his or her duties are performed or to be performed or as to his hours of work:
>
> Provided further that a person will be deemed to be carrying on a trade independently as aforesaid if he throughout the year of assessment employs three or more employees who are on a full time basis engaged in the business of such person of rendering any such service, other than any employee who is a connected person in relation to such person…

Paragraph 1(g), as of 1 March 2017, includes in the definition of remuneration any amounts received or accrued by way of a dividend as contemplated in section 10(1)(k)(i) of the Income Tax Act. This includes dividends received in respect of:

- restricted equity instruments as defined in section 8C of the of the Income Tax Act, paragraph (dd) of the proviso to section 10(1)(k)(i) of the Income Tax Act;
- dividends in respect of services rendered or to be rendered, paragraph (ii) of the proviso to section 10(1)(k)(i) of the Income Tax Act;
- dividends in respect of restricted equity instruments, as defined in section 8C, that were acquired in terms of section 8C(1) if that dividend constitutes an amount as consideration for the acquisition or redemption of any share in the company, an amount received in the course of winding up, deregistration or liquidation of a company or an equity instrument that does not , at the time of receipt or accrual qualify as a restricted equity instrument, paragraph (jj) of the proviso to section 10(1)(k)(i) of the Income Tax Act; or
- any dividend in respect of a restricted equity instrument, as defined in section 8C of the Income Tax Act and acquired in terms of section 8C(1), if the dividend is derived directly or indirectly from an amount as consideration for the acquisition or redemption of any share in a company or an amount accrued or received in anticipation of the winding up, liquidation, deregistration or final termination of the company, paragraph (kk) of the proviso to section 10(1)(k)(i) of the Income Tax Act.

It is evident from the above definition that "remuneration" includes various forms of income, including the value of any benefits granted as a result of rendering the services, the importance of this will be discussed in more detail in Chapter 5. For the purposes of this chapter it is necessary to consider the exclusions from remuneration as set out in paragraph (ii) of the

definition. Payments made in respect of services rendered to a person carrying on a trade independently are excluded from remuneration, unless that person is deemed to be an employee. Therefore, in addition to being resident, an individual who wishes to utilize the section 10(1)(o) of the Income Tax Act exemption must be an employee and cannot be an independent contractor. It is therefore necessary to consider the concept of an independent contractor.

4.4 INDEPENDENT CONTRACTORS

Paragraph (ii) of the definition of "remuneration" in the Fourth Schedule excludes payments made to independent contractors. Therefore, independent contractors who are resident in South Africa will be taxed on all income, including income earned abroad.

SARS Interpretation Note 17 (Issue 4) (South African Revenue Service, 2018) explains the statutory tests and the common law tests used by employers and SARS officials to classify a worker. The distinction between independent contractor status and employee status affects an employer's liability to deduct employees' tax and, in addition, has an impact on the application of the section 10(1)(o)(ii) exemption. It is evident from the definition of "remuneration" that any payments made to an independent contractor who carries on a trade and is tax resident in South Africa is excluded from the definition. SARS Interpretation Note 17 (Issue 4) (South African Revenue Service, 2018:3) states that there are "two sets of tools which can be utilised when determining whether a person is an independent contractor for employees' tax purposes". The first tool is referred to as the statutory tests and comprises two tests which are conclusive in nature. SARS Interpretation Note 17 (Issue 4) (South African Revenue Service, 2018:6) explains that the first test is "a provision deeming that a person will not carry on a trade independently if both parts of the test are satisfied." A person will be deemed not to carry on a trade independently if that person:

i. is required to render their services mainly (i.e. more than 50% of the time) on the premises of the person or company paying for such services and
ii. that person is subject to the control or supervision of any other person in respect of the manner in which his/her duties are to be performed or in respect of the hours of work

SARS Interpretation Note 17 (Issue 4) (South African Revenue Service, 2018:7) sets out the second test which states that "a person who employs three or more full-time employees, who are not connected persons in relation to him or her and are engaged in his or her business throughout the particular year of assessment, is deemed to be carrying on a trade independently".

The second of the statutory tests is the overriding test and will take precedence over the first test despite all the requirements of the first test being satisfied. The second test is the common law dominant impression test. SARS Interpretation Note 17 (Issue 4) (South African Revenue Service, 2018) explains that the dominant impression test requires one to consider numerous factors of varying significance in order to determine whether a worker is an independent contractor or an employee. It should be noted that no single indicator is conclusive, and the application of the factors should be used to establish the dependence or independence of a person. The factors, which need to be considered as part of the dominant impression test, are set out in three categories:

i. the first category consists of "near-conclusive" factors and relate "most directly to the acquisition of productive capacity";
ii. the second category consists of "persuasive" factors which go to establishing "the degree of control of the work environment"; and
iii. the third category consists of factors which are "resonant" of either an employee/employer relationship or an independent contractor/client relationship.

In practice the statutory tests are considered first. If the statutory tests do not give a definite answer it becomes necessary to consider the common law tests to establish the dominant impression as to whether a person is an employee or independent contractor. A finding in favour of a dependent status in terms of either the statutory or dominant impression test, is sufficient for there to be an employees' tax withholding obligation imposed on the "employer" and therefore the use of the section 10(1)(0)(ii) exemption may be applied if the provisions of the section are met.

SARS Interpretation Note 17 (Issue 4) states that the "Fourth Schedule statutory concept of an "independent trader" is similar to the common law concept of an "independent contractor" (South African Revenue Service, 2018:21). Annexure D of SARS Interpretation Note 17 (Issue 4) differentiates the concept of an "independent contractor" at common law and states that "an independent contractor must be distinguished from its counterpart, the employee. Legally, the two terms (independent contractor and employee) are mutually exclusive and direct opposites" (South African Revenue Service, 2018:21).

The case of *Smit v Workmen's Compensation Commissioner* [1979] 1 AII SA 152 (A), had to consider whether the appellant, at the time of an accident, was a "workman" in terms of the

Workmen's Compensation Act, No 30 of 1941. It was in this case that the dominant impression test first emerged in South Africa. Joubert, J.A stated (at 160) that

> The presence of such a right of supervision and control is indeed one of the most important *indicia* that a particular contract is in all probability a contract of service. The greater the degree of supervision and control to be exercised by the employer over the employee the stronger the probability will be that it is a contract of service. On the other hand, the greater the degree of independence from such supervision and control the stronger the probability will be that it is a contract of work…Notwithstanding its importance the fact remains that the presence of such a right of supervision and control is not the sole *indicium* but merely one of the *indicia*, albeit an important one, and that there may also be other important *indicia* to be considered depending upon the provisions of the contract in question as a whole.

In reaching its decision the court considered Roman Law and Roman Dutch Law. The following distinctions can be noted from the judgement of Joubert, J.A:

1. Locatio conductio operarum, which is the letting and hiring of personal services. This was described by Joubert, J.A (at 153) as a

   > consensual contract whereby a labourer, workman or servant as an employee (*locator operarum)* undertook to place his personal services (*operae suae)* for a certain period of time at the disposal of an employer (*conductor operarum*) who in turn undertook to pay him the wages or salary (*merces)* agreed upon in consideration for his services.

2. Location concutio operis, which is the letting and hiring of a particular piece of work or job to be done as a whole. In this situation the subject-matter of the contract is not the supply of labour or services but the product or result of the labour.

Joubert, J.A (at 155) continued to explain that, in terms of Roman Law,

> In all these instances the *conductor operis* undertook to produce a certain result on a person or physical thing which was handed to him by the *locator operis*. The *conductor operis* was bound to complete the work properly according to the specifications and terms of the contract. Inasmuch as he undertook to produce the promised result or product he was not bound to obey the orders or instructions of the *locator operis* in regard to the manner of carrying out the work. It was moreover not incumbent on the *conductor operis* to perform the work himself unless otherwise agreed upon.

Joubert, J.A went on to consider the general principles of Roman Dutch Law and stated (at 158), after consideration of case law, that:

> one of the important legal characteristics of *locatio conductio operarum* (dienstcontract) in Roman-Dutch law is the duty of the employee (*locator operarum*) irrespective of whether he happens to be a domestic servant or any other type of employee, to obey the lawful commands, orders or instructions of his employer (*conductor operarum*) in regard to the performance of his services. It follows that the employer (*conductor operarum*) has a concomitant right under (*locatio conductio operarum*) to supervise and control the manner in which the employee (*locator operarum*) is to perform his services. Control is a wide concept. It includes *inter alia* the right of an employer to decide what work is to be done by the employee, the manner in which it is to be done by him, the means to be employed by him in doing it, the time when and the place where it is to be done by him. Supervision implies the right of the employer to inspect and direct the work being done by the employee.

Joubert, J.A referred to the case of *Colonial Mutual Life Assurance Society Ltd.* v. *MacDonald*, 1931 AD 412, where this Court adopted the so-called supervision and control test of English law in determining whether an insurance agent was the employee (*locator operarum*) of a life insurance society or an independent contractor (*conductor operis*). This test, based on the right of supervision and control which a master (*conductor operarum*) has, according to English law, over his servant (*locator operarum*) was formulated as follows by De Villiers, C.J. (at p.434-435):

> But while it may sometimes be a matter of extreme delicacy to decide whether the control reserved to the employer under the contract is of such a kind as to constitute the employer the master of the workman, one thing appears to me to be beyond dispute and that is that the relation of master and servant cannot exist where there is a total absence of the right of supervising and controlling the workman under the contract; in other words unless the master not only has the right to prescribe to the workman what work has to be done, but also the manner in which that work has to be done. In *The Queen* v. *Walker*, (27 L.J.M.C.207) Bramwell, B, put it this way: 'A principal has the right to direct what the agent has to do; but a master has not only the right, but also the right to say how it is to be done.

It is evident from the above that Joubert, J.A noted that the presence of control and supervision is not the only factor to consider, but rather one of the important factors amongst others to consider in light of the provisions of a contract as a whole. It was therefore as a result of this judgement that the dominant impression test emerged.

Currently, in South Africa, the dominant impression test must be applied when distinguishing between an independent contractor and an employee. The starting point should be the contract between the parties as the contract will establish the rights and obligations of the parties. Where the object is placing a person's labour at the disposal of another, the contract is one of employment. If the object is the acquisition of a result, the contract is likely to be that of an independent contractor (SARS Interpretation Note 17 (Issue 4), South African Revenue Service, 2018).

The abovementioned definitions are essential when determining whether a person can apply the section 10(1)(o) exemption, particularly when a person wishes to apply the provisions of section 10(1)(o)(ii) of the Income Tax Act. Section 10(1)(o)(ii) only applies in respect of remuneration derived from an employer and will not apply in respect of income received by an independent contractor (Kruger & Scholtz, 2013). The distinction between an employee and an independent contractor is also of relevance when considering the application of a DTA. As discussed in chapter 3, Article 15 of the OECD Model Tax Convention deals with the taxation of foreign remuneration and allocates the taxing rights to the country in which the services are rendered. However, this too will only be applicable to an employee and not an independent contractor. It is therefore important to consider a person's employment status when that person is required to render services abroad.

Once it is established that a person is in receipt of foreign employment income, that the person is a "resident" of the Republic of South Africa, and that the remuneration received is as a result of rendering services for an employer, the additional requirements under each of the provisions of section 10(1)(o) of the Income Tax Act need to be considered in light of the circumstances of each case to determine whether the individual may successfully apply the exemption. However, as stated in Chapter 2, employers have the obligation to withhold employees' tax on remuneration paid to an employee and may only apply this exemption where they are satisfied that their employees meet the requirements of the relevant section. This may be a simple task for an employer to establish, particularly in respect of the application of section 10(1)(o)(iA), where there is no prescribed days test. However, the application of section 10(1)(o)(ii) may be more complicated, particularly where an employee is sent abroad for a specific project. The project timelines may change, resulting in an individual not meeting the required days test. Therefore, in light of the penalties imposed on employers for failure to deduct employees' tax, this has resulted in employers applying the exemption with caution, with many employers deducting

employees' tax, after which employees may claim a refund upon assessment of their individual tax return. The problem that individuals face in this instance is that a large refund often triggers a SARS review of the individual's tax return (Cliffe Dekker Hofmeyr, 2016).

This is not the only challenge with the application of the section 10(1)(o)(ii) exemption. Despite the intention of the legislature, section 10(1)(o)(ii) of the Income Tax Act alleviated the tax burden of double taxation but created a situation where individuals who worked in a tax haven and met the requirements of section 10(1)(o)(ii), were receiving tax-free income. This was clearly not the intention of the legislation. This was noted by Minister Pravin Gordhan, the Finance Minister at the time, during the National Budget Speech in February (National Treasury, 2017:7), in which he stated that "we operate within a connected global economic system. South Africa's economic performance is affected by global economic trends. We rely on global cooperation to address trade imbalances, the abuse of tax havens and the coordination of financial stabilisation efforts." This raised the concern that the foreign employment tax exemption could be seen as excessively generous, as individuals who met the requirements of section 10(1)(o)(ii) working in a country with no withholding obligations, were benefiting from double non-taxation. On the 19th of July 2017, National Treasury released the Draft Taxation Laws Amendment Bill, 2017, for public comment. Rather than amending the section to address the problem, section 14(f) of the Draft Bill proposed that the section 10(1)(o)(ii) exemption be deleted. However, after the promulgation of the Taxation Laws Amendment Act, 2017, section 16(1)(g), rather than deleting section 10(1)(o)(ii) of the Income Tax Act, introduced a R1 million limitation on the exemption.

4.5 CONCLUSION

The purpose of this chapter was to describe the relief mechanisms available to South African residents with particular emphasis on section 10(1)(o)(ii) of the Income Tax Act. A South African resident's primary mechanism to avoid double taxation is to claim the section *6quat* deduction or rebate. In terms of section 6*quat* of the Income Tax Act a resident may deduct foreign taxes from normal tax otherwise payable. The amount that may be deducted is equal to the sum of any taxes paid on income proved to have been made to another government. However, the amount that may be deducted is limited depending on the type of income that is received by the resident and the allowable deductions that are required to be considered in determining the foreign tax rebate that a resident is entitled to. In addition, the rebate may only be claimed if the foreign tax is in respect of income which forms part of taxable income in South Africa. If the

income is exempt in South Africa, no rebate may be claimed. While this alleviates double taxation, as a person is only entitled to a rebate equal to taxes paid, where the foreign tax is less than the South African tax, the person will be liable for the payment of the additional South African tax on the foreign income received.

Section 10(1)(o) of the Income Tax Act provides an exemption from normal tax in respect of any "remuneration", as defined in the Fourth Schedule, that is received by or accrues to any person in respect of any services rendered outside of South Africa on behalf of an employer. Essentially section 10(1)(o) provides an exemption in respect of three categories.

(i) Section 10(1)(o)(i) provides an exemption in two instances; the first to an officer or crew member of a ship who are outside the Republic of South Africa for a period or periods exceeding 183 days during a year of assessment, and the second in respect of ships engaged in prospecting, exploration, mining or the production of any minerals from the seabed outside South Africa, however, this is limited to officers and crew members who are employed on the ship solely for the purposes of passage.

(ii) Section 10(1)(o)(iA) of the Income Tax Act exempts any remuneration received by or accrued to any officer or crew member of a ship, which is mainly engaged in international shipping or fishing outside the Republic of South Africa, regardless of the period or periods spent outside the Republic of South Africa.

(iii) Section 10(1)(o)(ii) of the Income Tax Act exempts any remuneration received, provided that, firstly, the person claiming the exemption is physically outside of South Africa for more than 183 days in a 12-month period. This 12-month period does not need to fall within the year of assessment, but a 12-month period from the date of departure. Secondly, the person must be outside South Africa for 60 full days within the respective 12-month period.

The section 10(1)(o) exemption, with specific reference to section 10(1)(o)(ii) of the Income Tax Act, assists in relieving a person from the potential of being subjected to double taxation when receiving remuneration from rendering services abroad. However, the exemption is subject to a person receiving "remuneration" as defined in the Fourth Schedule. Remuneration is defined broadly and includes many different categories of remuneration. Analysis of the definition of "remuneration" revealed that paragraph (ii) of the definition specifically excludes:

> any amount paid or payable in respect of services rendered or to be rendered by any person (other than a person who is not a resident or an employee contemplated in paragraph (b), (c), (d) or (e) of the definition of "employee") in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered…

Section 10(1)(o)(ii) of the Income Tax Act therefore specifically precludes independent contractors from utilising the section 10(1)(o) exemption. A distinction was drawn between an employee and an independent contractor who is rendering services abroad. In this regard the case of *Smit v Workmen's Compensation Commissioner* was considered. It was in this judgement of Joubert, JA that the "dominant impression test" was established. Based on the discussions above, it can be concluded that that in order to distinguish between an independent contractor one needs to begin with looking at the contract between the parties, determine the presence of supervision and control, determine where the services are predominantly rendered and finally consider all other factors, in order to establish the relationship between the parties. A person will be an employee where he/she is subject to the control or supervision of another person, and he/she provides labour at the disposal of another person. A person will be independent where he/she agrees to deliver a specific result or product, rather than the provision of their services to another person.

Employers have an employees' tax withholding obligation and therefore the requirements for the application of the section 10(1)(o) exemption play an important role for both individuals and businesses when electing to either render services abroad or to send employees abroad. The intention behind the introduction of section 10(1)(o) of the Income Tax Act, specifically section 10(1)(o)(ii), was to alleviate the tax burden of individuals rendering services abroad. However, contrary to the intention of the legislature, the exemption not only alleviated the risk of double taxation but gave rise to the situation of double non-taxation. This resulted in the proposed and subsequent amendment to the section 10(1)(o)(ii) exemption, which will be discussed in detail in Chapter 5.

CHAPTER 5: EFFECT OF THE AMENDMENTS TO SECTION 10(1)(o)(ii) OF THE INCOME TAX ACT

5.1 INTRODUCTION

Chapter 4 provided an overview of the relief mechanisms available to a South African resident in receipt of foreign income, with specific reference to section 10(1)(o)(ii) of the Income Tax Act and the receipt of foreign employment income. Chapter 4 established that in order to utilise the exemption an individual must be in receipt of "remuneration" and must be an employee. It was established that "remuneration" includes many different types of remuneration including benefits provided to an employee by an employer. In terms of paragraph (ii) of the definition of "remuneration" in paragraph 1 of the |Fourth Schedule to the Act, amounts received by independent contractors do not constitute remuneration. The distinction between an independent contractor and an employee was therefore discussed. In order to determine the independent or employee status of a person, the facts and circumstances of each case need to be considered. The Act provides for a statutory test, which focuses on two requirements, namely, the "mainly required to render services at the premises of the employer" and the "control and supervision by the employer" tests. In addition, the common law provides for a "dominant impression test", which is applied based on the facts of the appointment.

Chapter 4 highlighted that section 10(1)(o)(ii) of the Income Tax Act created a situation where individuals who worked in a tax haven and met the requirements of section 10(1)(o)(ii), were receiving tax-free income. This was clearly not the intention of the legislation. This was noted by Minister Pravin Gordhan, the Finance Minister at the time, during the National Budget Speech in February 2017. This resulted in the release of Draft Taxation Laws Amendment Bill, 2017 for public comment. Rather than amending the section to address the problem, section 14(f) of the Draft Bill proposed that the section 10(1)(o)(ii) exemption be deleted. However, after the promulgation of the Taxation Laws Amendment Act, 2017, section 16(1)(g), rather than deleting section 10(1)(o)(ii), introduced a R1 million exemption.

The goal of this chapter will be to set out the proposed amendments to section 10(1)(o)(ii) of the Income Tax Act, present the arguments for and against the proposed amendments and discuss the final amendment which comes into effect on 1 March 2020. Chapter 5 will seek to answer the following questions:

(i) What were the concerns regarding the amendment to section 10(1)(o)(ii) of the Income Tax Act?
(ii) Does the final amendment address these concerns?
(iii) What potential hardships do individuals face in light of the final amendment?

5.2 PROPOSED AMENDMENTS TO SECTION 10(1)(o)(ii) OF THE INCOME TAX ACT

As stated in Chapter 4, section 14(f) of the Draft Taxation Laws Amendment Bill, released for comment during July 2017, proposed the repeal of section 10(1)(o)(ii) in its entirety. This meant that individuals rendering services abroad would no longer be entitled to an exemption, resulting in foreign employment income being included in the taxable income of an individual.

Peyper (2017) discussed the presentation given to Parliament's Standing Committee on Finance (SCoF) during August 2017. During the presentation National Treasury elaborated on the proposal to repeal the section 10(1)(o)(ii) exemption. Peyper (2017) explained that, during the presentation, Chris Axelson, director of personal income taxes and saving at National Treasury, discussed the issue of the exemption creating the opportunity for double non-taxation. Peyper (2017) reported that National Treasury noted that the exemption was never intended to create a situation where income is neither taxed in South Africa nor in the foreign host country and therefore it was necessary to repeal the exemption to eliminate the opportunity for double non-taxation. Peyper (2017:1) further stated that Axelson went on to explain that the effect of the repeal will mean that:

> all South African residents will be subject to tax on foreign employment income earned for services rendered outside of the country, with relief from foreign taxes paid on the income under section 6quat (the claiming of foreign taxes paid or proved to be payable by a taxpayer as a deduction from a taxpayer's South African tax liability) of the Taxation Laws Act.

Peyper (2017:1) went on to report discussions with journalists on the side-lines of the Parliamentary briefing, during which Ismail Momoniant, Head of Tax and Financial Section Policy at National Treasury, stated that "the implications of this repeal can be significant, but the key issue is you can't live in a world without taxation. If you live in a tax haven and you have connections here in South Africa, you must pay your share."

It is evident from the reasons provided by National Treasury that, despite there being a need for the exemption for foreign employment income, it was never intended by the legislator that the exemption would result in double non-taxation. Therefore, an amendment would need to be made to close the loophole created by section 10(1)(o)(ii) of the Income Tax Act. This would ensure that there is no loss to the *fiscus* and individuals who are not being taxed abroad are subject to tax in South Africa.

The manner in which National Treasury sought to close this loophole led to much debate and concern. Chapter 4 of the Constitution, however, sets out the national legislative process and determines that "Parliament is the national legislature (lawmaking body) of the Republic". In terms of the legislative process, where a bill is subject to public interest, public hearings may be arranged to allow written comments and occasionally oral representations in respect of the provisions of the bill. In terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill (National Treasury: 2017), after the publication of the Draft Taxation Laws Amendment Bill during July 2017, the public were then permitted to submit written comments by the 18th August 2017. The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill (National Treasury, 2017:4) states further that:

> National Treasury and SARS received responses from 1 420 organisations and individuals on the Draft 2017 TLAB and the Draft 2017 TALAB. Public comments to the SCoF were presented at a hearing that was held on 29 August 2017. There were 11 organisations that submitted their comments to the SCoF for public hearings. Subsequently, National Treasury and SARS held public workshops on the public comments on 4 and 5 September 2017.

On 14 September 2017 the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (Based on report-back hearings to the Standing Committee on Finance in Parliament) was published. The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury, 2017: 4) "contains draft responses to the most pertinent issues raised by the public during the public hearings and workshops."

5.3 ARGUMENTS AGAINST THE REPEAL OF SECTION 10(1)(o)(ii) OF THE INCOME TAX ACT

It is evident from the number of responses received that the proposed repeal of section 10(1)(o)(ii) of the Income Tax Act created widespread concern, particularly for the individuals who render services abroad and those employers who require their employees to render services abroad.

Visser (2017:1), in an article entitled "*Widespread hostility to foreign tax as potential costs are scrutinised",* stated that "the South African Institute of Tax Professionals (SAIT) has requested an economic analysis on the potential impact of the scrapping of the foreign employment income exemption". In a submission to National Treasury, Beatrie Gouws, the Vice-Chair of SAIT's personal tax committee, stated that:

> the direct cost of the increased tax burden, which will be borne by employers as a result of the repeal is likely to have a significant impact on their bottom line. Particular concerns are possible retrenchments, the continued competitiveness of South African business in the continent, and of South Africa as the 'Gateway to Africa'.

Santana (2017:1) stated that "South Africans living in foreign countries therefore need to consider whether it is their intention to come back to South Africa after their stay in the foreign country and commence with serious tax planning to mitigate the tax they are now going to be levied with."

Yunus Carrim, Chairman of the Standing Committee on Finance, asked that "the National Treasury must consult with the affected parties and revert to the committee with some sort of a 'deal'" (Botha, 2017). Sessions were held during September 2017. Botha (2017:1) stated that:

> the approach of National Treasury, under the guidance of Christopher Axelson, emphasised the imperative to protect the interests of South Africa and to ensure a progressive tax system, aligned with international standards. South Africans who venture internationally must be encouraged to come back to South Africa, as there are dire skills shortage in certain industries.

National Treasury (2017:4) stated that The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 "contains draft

responses to the most pertinent issues raised by the public during the public hearings and workshops", each of which will be discussed below.

5.3.1 The tax will have a severely negative impact on finances and remittances to South Africa, especially on lower incomes

The first comment in terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), was that the tax will have a severe negative impact on finances and remittances to South Africa, especially on lower incomes; this includes amounts remitted to fund the costs of families living in South Africa, investment of foreign income in family-run businesses and money spent on visits to South Africa.

This comment was accepted by National Treasury and it was agreed that the proposal would be changed to allow the first R1 million of foreign remuneration to be exempt from tax in South Africa if the individual is outside of the Republic of South Africa for more than 183 days, as well as for the continuous period of longer than 60 days during a 12-month period. National Treasury stated that the exemption threshold would reduce the impact on lower- to middle-income South African tax residents.

5.3.2 The cost of living in foreign countries is higher than in South Africa

The comment regarding the cost of living in foreign countries in the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), was that this should be taken into account when designing tax. The higher cost would include consumption taxes, high foreign levies, fees and user charges, which cannot be taken into account as foreign tax credits.

National Treasury responded to this by stating that the tax system does not usually cater for differences in the cost of living and other countries do not include these types of taxes in granting a foreign tax credit. National Treasury went on to state that the exemption threshold of R1 million will assist in mitigating these concerns (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.3 Individuals made the decision to work and live abroad based on current tax treatment

In view of the introduction of the residence-based system of taxation, many individuals and households made the decision to work abroad, these decisions were made based on the tax treatment in place at this time. The comment was made in the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017) that it would be unfair to make such a sudden and large change in tax liabilities in one year, especially where taxpayers had made plans according to a three- to five-year contract.

National Treasury partially accepted this comment and stated that to allow more time for individuals to adjust their contracts or circumstances, the effective date for the proposed amendment would be extended to 1 March 2020 (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.4 The amendment is unduly harsh and sets South Africa apart from other countries

In terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), the comment was made that only two out of 196 other countries have implemented a proposal of this nature.

National Treasury rejected this comment stating that the policy mentioned in these two countries is where individuals are taxed based on citizenship. National Treasury stated that this proposal is not based on citizenship but is based on tax residency, which is a common principle amongst other countries who operate a residence-based system of taxation (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.5 The proposal will lead to an acceleration of formal emigration from South Africa

The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017) stated that the proposal will lead to an acceleration of formal emigration from South Africa and that, while the capital gains tax exit charge would result in a revenue gain, the loss in future revenue would be larger.

National Treasury again rejected this comment on the basis that the proposal is not related to citizenship. National Treasury reiterated that the application of taxation rests solely on tax residency and that even where individuals give up their citizenship, they may find that they are still resident in South Africa and therefore subject to tax (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.6 The proposal will lead to an accelerated breaking of South Africa tax residence

The comment was raised in terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), that this proposal would result in an accelerated breaking of South African tax residence, including by individuals who had been out the country for more than five years, some of whom envisaged retiring in South Africa, but will now not be willing to do so.

National Treasury noted this comment and stated that they encouraged the formalisation of the tax residency status of South African tax residents who left the country years ago. National Treasury stated that South Africans who are no longer tax resident are welcome to return to South Africa and that there are no barriers from a tax perspective if their tax affairs are in order (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.7 The proposal increases the cost of employment of South African residents working abroad

The concern raised, in terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), is that this will put South African residents at a disadvantage compared to other foreign workers and, as a result, could jeopardise the growth of South African multinational companies in other tax jurisdictions (or bias their hiring in favour of foreign workers).

National Treasury noted this response and stated that the introduction of the R1 million exemption should alleviate the increased taxation costs associated with employing South Africans abroad (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.8 The foreign tax credit may only be claimed on assessment

In terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), the comment made in this regard related to the foreign tax credit only being claimed on assessment, which meant that taxpayers in employment and provisional taxpayers pay taxes in two jurisdictions and only claim the credit afterwards, this would result in severe cash flow problems and provisional tax liabilities would also be difficult to estimate.

National Treasury rejected this statement, stating that employers are able to apply for a hardship directive from SARS that effectively would take foreign employment taxes into account in the determination of employees' tax, which effectively removes the incidence of being taxed twice during the course of a year and only being able to claim foreign tax credits on assessment at a later stage. For provisional taxpayers the law and tax forms currently do allow taxpayers to include foreign taxes paid in their calculations and should not result in adverse cash flow consequences (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.9 There are very long delays in processing and allowing foreign tax credits

In terms of the Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), the concern was raised that this proposal would overwhelm the current system.

National Treasury, once again, rejected this, claiming that the tax credit system as administered by SARS is already functioning and the increase in applications for credit should be limited due to the availability of the R1 million exemption (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.10 Amendments are required to be made to section *6quat* of the Income Tax Act

It was argued that further amendments would need to be made to amend section 6*quat* of the Income Tax Act to take social security and pension contributions into account, and include a deduction under section 11F (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

National Treasury did not accept this argument and stated that social security contributions have a different nature to taxes on income. In respect of state pensions paid by other countries to South African residents, these are free from tax and allowing a credit for these could be seen to be allowing a tax deduction for both contributions and payments. National Treasury went further to state that the general international practice is to allow only taxes on income as foreign tax credits and not social security contributions (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.3.11 The draft legislation goes further than the proposal in Annexure C of the 2017 Budget Review

The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017), raised the comment that the initial proposal suggested that an amendment would be made to eliminate the loophole that section 10(1)(o)(ii) of the Income Tax Act provided that resulted in an individual benefiting from double non-taxation. This suggested was that only a part of the section would be amended, rather than a repeal of the entire sub-section.

National Treasury noted this response and advised that the proposal was revised, as when drafting it was noted that should an exemption only apply to employment in jurisdictions with no income tax it may inadvertently have favoured jurisdictions with very low rates of income tax. The proposed amendment seeks to equalise the tax treatment of South African tax residents who render employment services in all countries. What this means is that upon drafting it was noted that by making an amendment to only eliminate the “loophole” that was provided by the exemption, i.e. double non-taxation, this would then favour jurisdictions with perhaps a lower tax rate than South Africa. Therefore, it was decided that to ensure equality of tax treatment the section would be repealed in its entirety.

5.3.12 It is unfair to impose taxes on people who are not present in South Africa to enjoy the benefits of public expenditure

The Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017) noted the comment that it is unfair to impose taxes on people who are not present in South Africa to enjoy the benefits of public expenditure.

This was not accepted by National Treasury, as the residence-based system of taxation is premised on the fact that residents of a country are liable for tax on their worldwide income if they are tax resident in that country. This is determined by applying the "ordinarily resident" or "physical presence" test. If the individual does not meet either of these tests, the individual would not be tax resident in South Africa and is unlikely to benefit from any public expenditure (Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017 (National Treasury: 2017)).

5.4 THE TAXATION LAWS AMENDMENT BILL, 2017

It is evident from the above comments that the proposed amendment to repeal section 10(1)(o)(ii) of the Income Tax Act would have a negative impact on both individuals and employers. Many individuals who have elected to render services abroad have made the decision based on the fact that they would not be subject to tax in South Africa. These individuals would find themselves in an adverse position if the section had been repealed. National Treasury took note of these arguments and the impact that such a repeal would have and therefore revised the proposal.

The Taxation Laws Amendment Bill [B27 – 2017] was promulgated as Taxation Laws Amendment Act, 2017 (Act No. 17 of 2017) on 18 December 2017 and in terms of section 16(1)(g), section 10(i)(o)(ii) of the Income Tax Act, 1962, was amended –

> (g) by the substitution in subsection (1)(*o*)(ii) for the words preceding item (*aa*) of the following words:
>
> "to the extent to which that remuneration does not exceed one million Rand in respect of a year of assessment and is received by or **[accrued]** accrues to any employee during any year of assessment by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, including any amount referred to in paragraph (*i*) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C, , in respect of services rendered outside the Republic by that employee for or on behalf of any employer, if that employee was outside the Republic … (emphasis in the original)

Therefore, persons who render services abroad will be exempt from tax on up to the first R1 million of remuneration, provided they meet the requirements of section 10(1)(o)(ii). Any amount in excess of R1 million will be subject to tax in South Africa.

5.4.1 The R1 million exemption limit

Individuals who render services abroad will be entitled to an exemption on the first R1 million of remuneration only.

Chapter 4, discussed the definition of "remuneration" and explained that remuneration is made up of a number of different forms of remuneration. In terms of the extended definition, paragraphs (a) to (g) include in the definition, any amounts received by or accrued to a person in respect of annuity payments, amounts received as a result of services rendered, including the receipt of any voluntary awards, any amounts received by way of restraint of trade payments, amounts in respect of the termination, relinquishment or cancellation of employment or office, retirement fund lump sum benefits, and the cash equivalent of the value of any benefits or advantages granted in respect of employment. Furthermore, paragraph (g) of the definition includes in remuneration any amounts received or accrued by way of a dividend as contemplated in section 10(1)(k)(i) of the Income Tax Act, i.e. dividends, other than dividends paid or declared by a headquarter company, received by or accrued to any person. Therefore, based on the definition of "remuneration", when calculating the R1 million exemption limit, it is suggested that it is not only the salary that will be considered but the total remuneration of the individual. This may include a number of benefits granted by the employer to the employee and any voluntary awards granted. The question therefore arises, is this the intention of the amendment?

Atkinson (2019:14) in her article *Foreign services exemption – where are we now,* highlights that there are "multiple areas of concern in how the legislation is going to be implemented and whether further legislative amendment is required in order to operationalise the new dispensation." The author continues to discuss two categories of residents affected by the amendment and the challenges faced by these individuals. Atkinson (2019) explains that the first category of residents is those who elect to work abroad, for example teachers wishing to teach abroad. The author explains that the key challenges the resident faces will be determining whether the R1 million threshold is met. Atkinson (2019:14) explains that "given changes in exchange rates this could vary from year to year." Furthermore, the author raises the concern as to whether these residents declare their income or submit their tax returns. Atkinson states (2019:15) that:

> the general view is that a large proportion of the foreign workers do not file tax returns in South Africa and will in fact need to regularise their tax affairs. A further complication is

> that a portion of this community may in fact opt to cease residency in totality, thereby exiting South Africa's tax base. This will create a loss of taxable income streams via future employment, retirement or investment.

The second category relates to residents who are seconded abroad by a multinational employer. In this regard, Atkinson (2019:15) explains that "for multinational employers, the lack of clarity around their obligations under the new legislation creates uncertainty and hampers planning going forward." The author explains that, previously, the exemption permitted the employer not to withhold employees' tax if they were satisfied the requirements were met. Atkinson states (2019:15) that:

> the introduction of a threshold complicates this. In a secondment model it is highly unlikely that a secondee would earn below the threshold, resulting in detailed calculations needing to be done to determine what is subject to tax and what is not. This is further complicated by trying to evaluate what will fall in remuneration in the first instance, taking into account the different jurisdictions that a secondee could work in.

Atkinson (2019:15) goes further to state that:

> The role of the employer in the secondment space has yet to be clarified and this largely impacts the collection of the tax. Will the multinational employer be expected to collect or withhold taxes on the remuneration of the employee, apply a foreign tax credit on payroll and then remit the difference to SARS? Should this approach be adopted, the challenge is that there often is no cash against which to withhold taxes in South Africa as the employee is remunerated in the foreign jurisdiction and foreign taxes are already being withheld against that remuneration. This will require the employer to fund the tax from its own funds, thereby creating a loan on behalf of the employee, which could also be subject to tax as a taxable fringe benefit.

Manyi (2018:37) in her article *Expat aftershock: surviving without the exemption*, explains that the amendment will create a double tax situation for South African tax residents who earn above the threshold. The author explains that:

> employers with South African tax resident employees working outside of South Africa may also be impacted, particularly those with tax equalisation and tax protection models, that make the employer liable for any income tax implications that arise for an individual employee by virtue of an international assignment.

Manyi (2018:37) continues to explain that relief from double taxation will exist in the form of the section 6*quat* credit and she highlights that the credits are limited to the amount of tax the individual would have paid had the income been earned in South Africa, but that no credits can be claimed in respect of taxes such as social security tax that would have been paid in the foreign country.

Therefore, while section 6*quat* offers additional tax relief, this is limited to amount of tax that the individual would have paid had the amount been earned in South Africa. This means that where the income was subject to tax in a jurisdiction with a higher tax rate than that in South Africa, the individual will not be permitted to claim the full tax credit. Furthermore, payments in respect of social security will not be credited, which results in an individual suffering more taxes despite remaining South African tax resident. In addition, what constitutes taxable income in one jurisdiction may not be deemed to be taxable in South Africa, resulting in individuals not being permitted to claim a foreign tax credit on certain amounts.

The author went further and considered whether renouncing tax residence would be the only solution to avoid double taxation. In this regard, she explained that South African residents, considering this option, would face a capital gains exit charge. In respect of employers, Manyi (2018:38) stated that:

> for employers of South African tax residents working abroad, hiring South African tax residents for services to be rendered outside of South Africa is no longer an attractive model to adopt. This may lead to a change in their global mobility strategy, which may now look to attract non-South African resident talent for roles requiring services to be rendered outside of South Africa.

It is evident from the discussion above that the legislation appears to be silent on how the R1 million should be calculated. This has resulted in ambiguity for both the individuals and employers and is a factor that should be considered when electing to work abroad. Manyani (2018), it is submitted, correctly identifies that employers with tax equalisation policies in place may be impacted by the amendment. Employers will therefore need to readdress their equalisation policies as this would have an effect on the total cost of employment, particularly where the employer is funding the tax on benefits provided to an individual.

5.5 CONCLUSION

It is evident that the section 10(1)(o)(ii) of the Income Tax Act exemption plays an important role for both individuals and businesses when electing to render services abroad or to send employees abroad. The exemption assisted in relieving a person from the potential of being subjected to double taxation. However, contrary to the intention of the legislature, the exemption not only alleviated the risk of double taxation but gave rise to the situation of double non-taxation. This resulted in the proposed repeal of the section 10(1)(o)(ii) exemption. This created much concern and, as stated by Atkinson (2019:14) "the public outcry was enormous in comparison to the response that the draft legislation would normally elicit and National Treasury was inundated with submissions on the proposed repeal." Arguments were presented to National Treasury and it was finally agreed that the exemption would not be repealed, but that a R1 million exemption would be introduced. This R1 million exemption would seek to reduce the tax burden and would assist those in the lower income brackets, as anyone earning below R1 million would be exempt from tax. It will only be those individuals earning above R1 million who will be subject to tax in South Africa, in respect of foreign employment income.

The limited exemption seeks to reduce the tax burden and assist those in lower income earning brackets. Individuals earning below the limit will continue to be exempt while those earning more than the R1 million will be subject to tax on their foreign income employment, therefore resulting in a potential double tax risk for the higher income earners. Whilst the foreign tax credit may be claimed, this is limited to the income taxable in South Africa, therefore any amount not taxable in South Africa, but taxable abroad, would not be permitted to be claimed as a tax credit. Furthermore, any social security paid abroad is not permitted as a tax credit.

While it is submitted that the R1 million will assist in alleviating the burden placed on those lower income earners, it is evident that there is still ambiguity as to how the R1 million should be calculated. The discussion above illustrates that the legislation needs to provide guidance to both individuals and employers as to how to calculate remuneration for the purposes of the exemption.

Chapter 6 will consider the approach adopted by the UK, Australia and the US in respect of foreign employment income.

CHAPTER 6: AUSTRALIA, UNITED KINGDOM AND UNITED STATES OF AMERICA: THE TAX PRINCIPLES OF RESIDENCY AND FOREIGN EMPLOYMENT INCOME RELIEF

6.1 INTRODUCTION

Chapter 5 explained the effects of the amendment to section 10(1)(o)(ii) of the Income Tax Act on individuals in receipt of foreign employment income, the effect on a company sending individuals abroad and on the final amendment to section 10(1)(o)(ii). This chapter will consider the relevant legislation in Australia, the UK and the US and illustrate how foreign employment income is treated in each of the respective jurisdictions.

The goal of this chapter is to demonstrate how foreign employment income and the potential issue of double taxation is treated in each of the above-mentioned countries.

6.2 AUSTRALIA

In terms of the Australian Taxation Office, *International tax for individuals* (ATO, 2018:1), "Australian residents are generally taxed on their worldwide income from all sources". A foreign resident or a temporary resident of Australia is generally only taxed on income from an Australian source. It is evident that, similar to South Africa, a person's tax liability is dependent on whether the person is a "resident" in Australia. Consequently, there is a risk that an Australian resident will be subject to tax in both Australia and the foreign country in respect of the same income, resulting in double taxation. Australia has recognised that the double taxation is an unfair burden on an Australian resident and has entered into DTAs with many countries. In addition, a foreign income tax offset may be claimed by an Australian resident where foreign tax has been paid on employment income in another country. Each of these will be discussed below.

6.2.1 Double Tax Agreements

The Australian Taxation Office publication, *International tax agreements* (ATO, 2016), reports that Australia has entered into DTAs with more than 40 countries in order to prevent double taxation and fiscal evasion. The DTAs promote cooperation between Australia and other tax authorities and provide a level of security in respect of the tax rules that apply to international transactions. The Australian DTAs have a number of basic principles; in respect of individuals the following principles apply:

- the DTAs give the source country a taxing right over selected types of income;
- each country has the right to tax the income of its own residents under their own domestic laws; and
- where the country of residence has the sole taxing right in respect of certain types of income, the DTA will expressly state that the income will only be taxable in that country.

The Australian Taxation Office publication, *International tax agreements* (ATO, 2016), submits further that a person's residence status determines the country in which tax will need to be paid. The DTAs generally contain a "tie breaker" clause in terms of which a dual resident will be deemed to be a resident of one of the two countries for taxation purposes. Therefore DTAs, as far as possible, seek to alleviate the burden of double taxation. To the extent that tax relief is not provided, the DTA permits the country of residence to provide tax relief against its own tax if the income has been taxed in the country of source. Australia has introduced a foreign income tax offset in respect of foreign income received or accrued to an Australian tax resident.

6.2.2 Foreign income tax offset

The Australian Taxation Office publication, *Guide to foreign income tax offset rules* (ATO, 2017), explains how the foreign income is treated and when a tax offset for the foreign tax paid on income may be claimed. The Guide explains that an Australian resident can claim a foreign income tax offset provided that they:

- have actually paid, or be deemed to have paid, an amount of foreign income tax; and
- the income or gain on which a person paid foreign income tax must be included in that person's assessable income for Australian tax purposes.

In terms of The Australian Taxation Office publication, *Guide to foreign income tax offset rules* (ATO, 2017), the foreign income tax offset is claimed in the Australian resident's income tax return and seeks to provide relief to the extent that the income was taxed offshore. The foreign income tax offset may only be claimed after payment of the foreign tax. The foreign tax is an offset and is a non-refundable tax offset, which means that the offset reduces the income tax payable by a person, rather than providing the individual with a refund.

Section 770.75 of the Income Tax Assessment Act, 1997, No. 38 states that there is a limit, referred to as the "offset limit", to the amount a person may claim in a tax year. The amount of the foreign tax that qualifies to be offset is limited to the amount of the Australian tax that would

be payable in respect of the foreign income. Where a person claims a foreign tax offset and the amount being claimed is less than AU$1 000, the individual will disclose the actual foreign tax paid on his or her assessment. Where an individual claims a foreign tax offset of greater than AU$1 000, the "offset limit" will need to be calculated. The offset limit is based on a comparison between a person's tax liability and the tax liability a person would have incurred, if certain foreign-taxed and foreign-sourced income and related deductions were disregarded.

It is evident that the foreign income tax offset adopted by Australia, is a credit that reduces the tax payable by an Australian resident. Australia has prescribed an "offset limit" for foreign income tax greater than AU$1 000. Australia permits an Australian resident, who has a foreign tax offset in excess of AU$1 000 to calculate an "offset limit" based on the equivalent Australian tax that would have been incurred if the foreign income had been from an Australian source, therefore offering the individual an opportunity to offset an amount greater than the AU$1 000 limit. Similarly, section 6*quat* of the South African Income Tax Act offers either a rebate to be deducted from the tax liability (calculated in a way very similar to the Australian offset exceeding AU$1 000), or a deduction from income of the foreign tax.

6.3 UNITED KINGDOM

In terms of the Her Majesty's Revenue and Customs ("HMRC"), Guidance Note: *Residence, Domicile, and the Remittance Basis* (HMRC, 2016), UK residents are taxed on their worldwide income. United Kingdom ("UK") residents are taxed on the "arising" basis of taxation which means that individuals pay UK tax on their worldwide income and gains for the tax year in which they arise. Therefore, where an individual is in receipt of foreign income and that income has been taxed in the other country, the foreign income will still be required to be included in the income of the individual and will be taxable in the UK. The UK offers relief in terms of DTAs or unilaterally. Where a person is resident but not domiciled in the UK, that person may elect whether to pay UK tax on foreign income on either the "arising" basis of taxation or the "remittance" basis of taxation. Where the "remittance" basis is elected an individual will be required to pay UK tax on income received or accrued in the UK and UK tax on any foreign income amounts that the individual "remits" to the UK. A person's UK tax liability depends on where that person is "resident" or "domiciled" in a tax year. (Her Majesty's Revenue and Customs, 2016).

6.3.1 Foreign income exemption

HMRC Guidance Note: *Residence, Domicile, and the Remittance Basis* (HMRC, 2016), explains that where a person is a UK tax resident that person will be taxed on the "arising" basis, which means that all income, regardless of its source, will be taxable in the UK. The UK, like Australia and South Africa, enters into DTAs in order to alleviate the burden of double taxation. Where a person is in receipt of "small" amounts of income from abroad, the UK offers an exemption subject to certain monetary limits.

6.3.2 Double Tax Agreement

The HMRC Guidance note: *Residence, Domicile and the Remittance Basis*, (HMRC, 2018) explains that where a person is subject to double taxation, he or she may claim relief in terms of the relevant DTA. Where a person is resident of a country where the UK has a DTA and that person is not UK resident then an exemption or partial relief may be claimed on UK tax in respect of certain types of UK sourced income. Where a person is resident of a country with which the UK has a DTA and is resident of the UK, then provided there is a "tie breaker" clause in the DTA, that person may be entitled to an exemption. The HMRC Guidance note: *Residence, Domicile and the Remittance Basis*, (HMRC, 2018) explains that in respect of earnings from employment, an exemption will generally be granted provided the person is not present in the UK for more than 183 days in the period specified in the DTA and the remuneration is paid by an employer who is not resident in the UK and must not be borne by a UK branch of the employer.

6.3.3 Remittance basis of taxation

The "remittance basis of taxation" is an alternative tax treatment and is available to a person in receipt of foreign income, where that person is a UK resident but not domiciled in the UK. A person who elects the "remittance basis of taxation" will be liable for UK tax on all UK income and gains as well as the foreign income that the person "remits" to the UK. This means that where a person's employment duties in a tax year are for a non-UK employer and these duties are performed wholly overseas, the earnings will only be taxable in the UK if that person "remits" them to the UK. Where the duties are performed partly in the UK and partly abroad, the employment income will be taxable in the UK. Where a person is a long-term UK resident, the person may be required to pay a "remittance basis charge". This charge is a tax on part of the foreign income that a UK resident leaves outside the UK and nominates for this purpose. A

person will be required to pay the remittance basis charge where in a tax year that person has £2000 or more from overseas income or gains that they have not remitted to the UK. In terms of the HMRC Guidance note: *Residence, Domicile and the Remittance Basis*, (HMRC, 2018) a person will be a long-term tax resident where that person has been a UK resident in at least seven of the previous nine tax years. The "remittance basis charge" is additional to the UK tax paid and is in addition to any foreign income remitted to the UK.

6.3.4 Exemption for small amounts of foreign income

The HMRC Guidance note: *Residence, Domicile and the Remittance Basis*, (HMRC, 2018) states that, in addition to the "remittance basis of taxation", the UK offers an "exemption for small amounts of foreign income". A person who is a UK resident, is not domiciled in the UK, is employed in the UK and is a basic rate taxpayer, will qualify for the exemption provided that the income from overseas employment is less than £10 000, the overseas bank interest for the tax year is less than £100, all overseas employment income and interest is subject to foreign tax and that person has no other overseas income or gains. Where a person meets these requirements, that person will be taxed on the arising basis of taxation for that year and will not be required to remit the foreign income into the UK, nor will they be taxed on that foreign income.

6.3.5 PAY-AS-YOU-EARN guidance

In terms of the HMRC *PAYE guidance on Appendix 5:net of foreign tax relief* (HMRC, 2014), employers who are required to deduct foreign tax in addition to UK PAYE from the salaries of employees sent to work abroad, may apply to the HMRC in terms of the Appendix 5 arrangement. HMRC *PAYE guidance on Appendix 5:net of foreign tax relief* (HMRC, 2014) states that "the aim is to give provisional relief for double taxation to employees who must pay both UK tax and foreign tax from the same payment of earnings." The guide continues to state that "the arrangement is **not** statutory; it was devised under HMRC's care and management powers to save employers, employees and HMRC time and work by dealing with the issue of double taxation through the payroll" (emphasis in the original). Appendix 5 permits the deduction from their existing UK PAYE liability of the amount of foreign tax that an employee is liable to pay. Therefore, where a UK employer sends employees to work abroad, and the employees are subject to foreign tax deductions, Appendix 5 permits the employer to calculate the UK PAYE in terms of the normal tax tables. A credit may then be given for foreign tax actually payable and deducted from the employee's wages and paid to the overseas authority.

Where the foreign tax is higher than the UK PAYE, no further tax will be payable in the UK, however, where the foreign tax is less than the UK PAYE, the difference will be paid to HMRC. This method assists in alleviating the double taxation and assists in the cash flow of an individual, as he or she is alleviated from paying both the foreign tax and UK tax liability and faced with claiming a credit in the year-end returns (HMRC, *PAYE guidance on Appendix 5:net of foreign tax relief* , 2014).

The UK bases the tax liability of a person on whether a person is resident in the UK. In addition, the UK considers the domicile of a person when considering whether foreign income will be taxable in the UK. To alleviate the burden of double taxation the UK has adopted a "remittance basis of taxation" for individuals who are resident but not domiciled in the UK and an exemption for small amounts of foreign income earned. In this regard a monetary limit has been prescribed and may only be utilised where the foreign income is below £10 000. In addition, the HMRC has introduced an Appendix 5 arrangement for the situation where an employer sends its employees abroad to work. This arrangement alleviates the risk of double taxation and the cash flow impact on an individual who is required to pay taxes in both the foreign country and the UK. (HMRC *PAYE guidance on Appendix 5:net of foreign tax relief*, 2014).

6.4 UNITED STATES OF AMERICA

The Internal Revenue Service (IRS) Publication Guide 54: *Tax Guide for U.S Citizens and Resident Aliens abroad* (IRS, 2017:2) states that "if you are a U.S. citizen or resident alien, your worldwide income generally is subject to U.S. income tax, regardless of where you are living." For the purposes of understanding the USA tax laws, "The Code of Laws of the United States of America", Wikipedia (2018) states that:

> The **Internal Revenue Code** (**IRC**), formally the **Internal Revenue Code of 1986**, is the domestic portion of federal statutory tax law in the United States, published in various volumes of the United States Statutes at Large and separately as **Title 26 of the United States Code** (USC). It is organised topically, into subtitles and sections, covering income tax (see Income tax in the United States), payroll taxes, estate taxes, gift taxes, and excise taxes, as well as procedure and administration. Its implementing agency is the Internal Revenue Service (emphasis in the original).

In terms of the 14th Amendment of the United States Constitution, section 1 states that:

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

US citizens and resident aliens are subject to tax on their worldwide income, whereas non-resident aliens are subject to tax only on income that is sourced within the US.

6.4.1 Foreign income exclusion, foreign housing exclusion and foreign housing deduction

As stated above, U.S. citizens and resident aliens are subject to tax on their worldwide income. Title 26 of the Internal Revenue Code, Chapter 1 deals with normal taxes and surtaxes. In terms of section 911(a):

At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year-

(1) the foreign earned income of such individual, and
(2) the housing cost amount of such individual.

Section 911 (b)(1) defines foreign income as

(A) In general

The term "foreign earned income" with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

(B) Certain amounts not included in foreign earned income

The foreign earned income for an individual shall not include amounts-

(i) received as pension or annuity,
(ii) paid by the United States or an agency thereof to an employee of the United States or an agency thereof,

(iii) included in gross income by reason of section 402(b) (relating to taxability of beneficiary of nonexempt trust) or section 403(c) (relating to taxability of beneficiary under a nonqualified annuity), or

(iv) received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

Section 911(2)(D) states that the exclusion amount for any calendar year is $80,000, for calendar years 2002 and after, and this increases annually as prescribed.

In respect of the second exemption, housing cost amount, section 911(2)(c)(1) states that:

> The term "housing cost amount" means an amount equal to the excess of –
>
> (A) the housing expenses of an individual for the taxable year to the extent such expenses do not exceed the amount determined under paragraph (2), over
>
> (B) an amount equal to the product of –
>
> (i) 16 percent of the amount (computed on a daily basis) in effect under subsection (b)(2)(D) for the calendar year in which such taxable year begins, multiplied by
>
> (ii) the number of days of such taxable year within the applicable period described in subparagraph (A) of (B) of subsection (d)(1).

Chapters 4 and 5 of Publication 54: *Tax Guide for U.S Citizens and Resident Aliens abroad* (IRS, 2017) explain the foreign earned income and housing exemption and deduction as set out in section 911 of the Internal Revenue Service Code. The Publication 54: Tax Guide for U.S Citizens and Resident Aliens abroad (IRS, 2017:12) explains that, in order to claim the foreign earned income exclusion, the foreign housing exemption or the foreign housing deduction, the following three requirements must be met:

1. Your tax home must be in a foreign country.
2. You must have foreign earned income.
3. You must be one of the following.
   a. A U.S. citizen who is bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year.
   b. A U.S. resident alien who is a citizen or national of a country with which the United States has an income tax treaty in effect and who is bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year.

c. A U.S. citizen or resident alien who is physically present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months.

It is therefore necessary to consider each of these requirements briefly. Publication 54: *Tax Guide for U.S Citizens and Resident Aliens abroad* (IRS, 2017) explains that a person's tax home is the general area of a person's main place of business, employment or post of duty, regardless of where a family home is maintained. It is the place where a person is permanently or indefinitely engaged to work as an employee or self-employed individual. A foreign country as defined in Publication 54: *Tax Guide for U.S Citizens and Resident Aliens abroad* (IRS, 2017:12) "includes any territory under the sovereignty of a government other than that of the United States." In terms of the *bona fide* residence test, a person will meet the test where that person is a *bona fide* resident of a foreign country for an uninterrupted period that includes an entire tax year. The physical presence test is based on the time spent in a foreign country. In terms of the physical presence test a person will be physically present in a foreign country if that person spends 330 full days during a period of 12 consecutive months in that country.

Where the above requirements are met, an individual may claim the foreign earned income exclusion. In terms of Publication 54: Guide for U.S. Citizens and Resident Aliens abroad (IRS, 2017) a person can exclude an amount up to $102,100 of foreign earned income (during the 2017 year).

In respect of the foreign housing exclusion, Publication 54: Guide for U.S. Citizens and Resident Aliens abroad explains that it only applies to "amounts considered paid for with employer-provided amounts" (IRS, 2017:21). The Guide states that employer provided amounts include any amounts paid to an individual by an employer or incurred by the employer that are foreign earned income; this includes a person's salary, reimbursements for housing expenses, amounts paid to third parties, fair rental value of company-owned housing, etc. (IRS, 2017:21).

The foreign housing deduction, based on the explanation in the Publication 54: Guide for U.S. Citizens and Resident Aliens abroad (IRS, 2017), may be claimed where a person has self-employment income. There are certain limits; the housing deduction cannot be more than the foreign earned income, less any foreign earned income exclusion, plus any housing exclusions.

Publication 54: Tax Guide for U.S Citizens and Resident Aliens abroad (IRS, 2017:16) goes on to state that foreign earned income does not include the following amounts:

- The value of meals and lodging that you exclude from your income because the meals and lodging were furnished for the convenience of your employer.
- Pension or annuity payments you receive, including social security benefits.
- Pay you receive as an employee of the U.S. Government.
- Amounts you include in your income because of your employer's contributions to a nonexempt employee trust or to a nonqualified annuity contract.
- Any unallowable moving expense deduction that you choose to recapture as explained under *Moving Expense Attributable to Foreign Earnings in 2 Years* in chapter 5.
- Payments you receive after the end of the tax year in which you performed the services that earned the income. (Emphasis in the original)

If a person's tax home is in a foreign country and that person meets the *bona fide* residence test or the physical presence test, an election can be made to exclude a limited amount of foreign earned income.

6.5 CONCLUSION

The goal of this chapter was to demonstrate how the issue of double taxation is treated in Australia, the UK and the US.

It is evident that Australia, the UK and the US require an individual to declare all income, including foreign income, in their annual tax return and subject the amounts to tax, despite the amount also being taxed in a foreign country. DTAs have been entered into by each country, which assists in determining the country that holds the taxing rights in relation to the income. Where dual residence is in issue, the DTAs will determine the residence of a person in terms of the "tie-breaker" clause. To the extent that a DTA is not applicable or where a tax burden arises in respect of the double taxation of foreign employment income, each country has adopted mechanisms to alleviate the tax burden.

Australia provides a foreign income tax offset which must be claimed by the individual in his or her income tax return and will reduce the tax payable by that person for that income tax year. Australia has prescribed an "offset limit" for a foreign income tax offset of greater than AU$1000. Therefore, when claiming a foreign income tax offset of less than AU$1000, the full amount of the foreign tax paid may be utilised by the individual in reducing his or her tax liability. However, where the foreign tax paid exceeds AU$1000, an individual will be subject to an "offset limit" based on a calculation of what the tax liability would have been had the income

been from an Australian source. Similarly, section 6*quat* of the South African Income Tax Act offers either a rebate to be deducted from the tax liability (calculated in a way very similar to the Australian offset exceeding AU$1000), or a deduction from income of the foreign tax.

The UK provides relief for tax on foreign income in terms of the relevant DTA. In addition, where a person is UK resident but not domiciled in the UK, the UK resident can elect to use the "arising" basis of taxation or the "remittance" basis of taxation. Where the remittance basis is selected, the UK resident will only pay tax on income that arises in the UK or on any foreign income that he or she remits to the UK. Furthermore, the UK provides an exemption for small amounts of foreign income earned. In this regard a monetary limit has been set and will only apply where the foreign income is below £10 000. The HMRC, has gone a step further and has introduced an Appendix 5 arrangement. As discussed above, this is not a statutory arrangement, but rather a process which has been introduced to try to alleviate the double tax burden on an employee who has been sent abroad to work by his or her employer. The UK employer may apply to HMRC to apply this arrangement. The employer will then calculate the UK PAYE liability, the foreign tax payable will then be credited against the PAYE liability and only where there is a difference (where the foreign tax is lower than the UK PAYE liability) will the employee be required to pay the UK PAYE liability. This assists employees with their cash flow during a month as they are not paying the full PAYE liability in the UK, while still being required to pay the tax liability in the same month in the foreign country.

In the US, if a person is a US citizen or resident alien, that person will be subject to tax in the US on his or her worldwide income, regardless of where he or she lives. Where a person is in receipt of foreign income, the US provides relief in terms of a DTA and, in addition, offers relief in respect of foreign earned income and housing costs of the individual. The exclusion amount for foreign income is capped and increases annually. Therefore, an individual will only be permitted to exempt the foreign income up to a certain limit. In addition, the US offers the housing exemption or a deduction. The housing exemption may only be utilised where the amounts are paid for with employer-provided amounts, whereas the housing deduction may be used where the person has self-employment income. The US also excludes certain amounts from foreign earned income. As indicated above, these comprise certain benefits that may be provided as a result of an employee rendering services abroad. It is evident that, while the US subjects the world-wide income of a US citizen or alien resident to taxation in the US, relief measures have been provided, both by means of a DTA and/or domestic relief.

It is submitted that, when comparing the approach adopted by South Africa, with Australia, the UK and the US, all of these countries rely on a "residence-based" system of taxation. This means that residents are taxed on all income regardless of the source of the income and are subjected to the risk of double taxation. To alleviate the tax burden DTAs have been entered into by each of the respective countries with additional relief provided by way of domestic law in the form of a foreign tax credit and/or an exemption, subject to certain monetary limits.

South Africa, in the recent amendment to the section 10(1)(o)(ii) of the Income Tax Act exemption of foreign employment income, adopted a similar approach by placing a monetary limit on the foreign employment income exemption. Thus, the UK, the US and South Africa impose limits in respect of the exemption of the amount of foreign income earned. This means that foreign income, up to a prescribed amount, will be exempt from tax. However, the US goes further by excluding amounts provided or funded by an employer in respect of employee housing. The UK has also implemented a process to alleviate the PAYE liability placed on individuals who are required to work abroad and in doing so aims to ensure the monthly cash flow of an individual is not adversely affected.

It is submitted that the recent amendment to section 10(1)(o)(ii) of the Income Tax Act broadly aligns with how other countries treat foreign income and very often the exemptions offered are subject to a monetary limit. The discussion in Chapter 5, included a discussion of the definition of remuneration and it was established that remuneration includes all benefits provided to an individual as a result of rendering services to an employer. On a strict interpretation of the definition, when calculating the R1 million threshold, all benefits provided would be included, potentially increasing an individual's income to well above the R1 million limit. These benefits would be included in calculating the R1 million exemption. Based on the discussion above, it is submitted that South Africa should consider the approach adopted in the US and seek to offer some relief in respect of benefits offered to an employee. The US permits an exemption for housing. Very often, housing provided to an individual can result in an increased taxable income, and therefore including an exclusion for this will assist in individuals staying within the R1 million limit. Furthermore, the manner of collecting the tax should be considered. In the UK, the Appendix 5 arrangement seeks to alleviate the cash flow burden as individuals are only paying the difference in the UK tax liability, rather than paying the full UK tax liability and the overseas income tax liability with a credit being claimed later. It is submitted that South Africa could adopt a similar approach with the tax authorities and enter into similar arrangements.

The next chapter will be the concluding chapter and will provide a summary of the conclusions of each chapter as well as an overall discussion and concluding comments.

CHAPTER 7: CONCLUSION

7.1 INTRODUCTION

The main goal of the research was to highlight the tax consequences of and exemptions available to individuals who perform services abroad. In doing so, the impact that the amendment to section 10(1)(o)(ii) of the Income Tax Act has on individuals working abroad and on companies that employ them was analysed, whilst highlighting key factors that need to be considered when an individual elects to work abroad or when an employer requires an individual to work abroad. In doing so the thesis set out to achieve the following sub-goals:

- highlight key factors that need to be considered when an individual elects to work abroad, or when an employer requires an individual to work abroad;
- to present the definition of a "resident";
- to set out the relief mechanism and exemptions available to South African residents and distinguish between independent contractors and employees;
- to discuss the impact of Double Tax Treaties, in light of the OECD Model Tax Treaty;
- to discuss section 10(1)(o) of the Income Tax Act in its present form and its purpose;
- to explain the effect that the proposed changes to section 10(1)(o)(ii) of the Income Tax Act will have on resident individuals and companies that employ them; and
- to analyse the tax principles applying in the UK, Australia and the USA to deal with "double taxation", where residents are employed in foreign jurisdictions.

This chapter will provide summaries of the conclusions reached in chapters 2 to 6 and link the conclusions to the research goals of the thesis.

7.2 SUMMARY OF CONCLUSIONS

The goal of chapter 2 was to discuss South Africa's change from a source-based system of taxation to a residence basis of taxation and establish how a person's tax residency affected their tax liability. In doing so, chapter two analysed the definition of a "resident". Two tests were identified in establishing "residence", namely the "ordinarily resident test" and the "physical presence test". It was established that the "ordinarily resident test" is primarily a question of fact and each case needs to be decided on its own facts. In the case of *Cohen v Commissioner for Inland Revenue,* an *obiter* statement proposed that a person may be "resident" in more than one country at a time, but only "ordinarily" resident in one. The case of *Johnson v Johnson* was

referred to, which stated that a person would be "ordinarily" resident in the place to which he or she returned from his or her wanderings. After an analysis of the case law, chapter 2 established that the intention of a person is paramount when determining whether that person is "resident" in South Africa. The physical presence test is only applied when it is established that a person is not "ordinarily" resident in the Republic of South Africa. This test focuses on the number of days a person is physically present in the Republic of South Africa and is calculated on an annual basis. Once the above tests have been applied and it has been established that a person is resident in the Republic of South Africa, that person will be subject to tax on all income regardless of its source. Thus, a person who is tax resident in South Africa and who earns foreign income is subject to tax abroad and in South Africa in respect of the same income. South Africa, therefore, saw the need to introduce relief measures for a South African resident who earned foreign income. Section 10(1)(o) of the Income Tax Act was introduced to alleviate the tax burden. However, in order to utilise the exemption that person must be a tax resident. Chapter 2 therefore illustrated that the importance of determining the tax residence of a person is two-fold, firstly to establish tax residency and secondly to establish the relief mechanisms available to that person.

Chapter 3 set out to discuss the role of DTAs and explained how residency is determined from a Treaty perspective. The chapter identified that there were two types of double taxation, economic double taxation and juridical double taxation. Economic double taxation refers to the imposition of taxes by two or more states on different taxpayers in respect of the same income. For the purposes of this thesis the chapter focused on juridical double taxation and established that juridical double taxation arises as a result of residence and/or source conflicts. Chapter 3 highlighted that the purpose of DTAs is to resolve situations of dual residence. The chapter explained that DTAs specifically define "resident" and determine residency on a day-to-day basis. Where a person is found to be resident of both states, the DTA provides for a "tie-breaker" clause which sets out rules to determine which state should be granted the taxing rights. Where the taxing rights cannot be allocated to a state in terms of a DTA, the DTA provides for relief mechanisms and highlights that the domestic law provisions may apply in alleviating double taxation.

The object of chapter 4 was to provide an overview of the double tax relief mechanisms available to a South African tax resident. The chapter confirmed that where a person is subject to double taxation, relief can be obtained in terms of a DTA or domestic law. The first of the domestic relief mechanisms identified in chapter 4 was section 6*quat* of the Income Tax Act, which entitles a South African tax resident to a rebate or a deduction in respect of foreign taxes paid on foreign

income taxed in South Africa. Chapter 4 explained that section 6*quat* of the Income Tax Act may only be utilised by a South African tax resident and the deduction is only claimable where the foreign tax relates to income that is included in the resident's income; therefore a person cannot claim a rebate where foreign tax is paid on income that is not taxable in South Africa. The second relief mechanism identified in chapter 4 was section 10(1)(o) of the Income Tax Act. Section 10(1)(o) was introduced into the Act to assist in alleviating the tax burden of residents earning "remuneration" even further and to reduce the administrative burden that individuals faced when attempting to claim a foreign tax credit in terms of section 6*quat.* Section 10(1)(o) provides an exemption from normal tax in respect of any "remuneration", as defined in the Fourth Schedule, that is received by or accrues to any person in respect of any services rendered outside of South Africa on behalf of an employer. The chapter discussed the definitions which are key to the application of the exemption. One of the key requirements for the application of section 10(1)(o) is that the person must be in receipt of "remuneration". The chapter established that "remuneration" is broadly defined and includes many types of remuneration and is not merely limited to the salary of an individual. Furthermore, payments made to independent contractors are specifically excluded from the definition of "remuneration". The chapter proceeded to distinguish between an employee and an independent contractor and established that two tests need to be applied in determining the independent status of a person, namely the statutory test and the dominant impression test. This chapter illustrated that when determining whether a person is permitted to apply section 10(1)(o), not only is the person required to be a resident, but the person must be in receipt of "remuneration" and cannot be an independent contractor. This is an important fact to consider when an individual is working abroad, as it is only employees who may utilise the section 10(1)(o) exemption.

Chapter 5 considered the effect of the amendment to section 10(1)(o)(ii) of the Income Tax Act. Section 10(1)(o)(ii), in its present form, is based on two measures and provides for an exemption from normal tax in respect of any "remuneration" as defined in the Fourth Schedule that is received by or accrues to any person in respect of any services rendered outside of South Africa on behalf of an employer, provided the employee was outside the Republic of South Africa for 183 full days during a 12-month period, and for a continuous period of 60 full days during that period. Chapter 5 highlighted the concerns regarding section 10(1)(o)(ii), and that, despite the intention of the legislature, the section created a situation that where an individual who worked in a tax haven and met the requirements of section 10(1)(o)(ii) would receive tax free income. The chapter set out the most pertinent issues raised during the public hearings and workshops in

response to the proposed repeal of section 10(1)(o)(ii). National Treasury noted the arguments and revised the proposal with the final amendment introducing a R1 million exemption limit to foreign earned remuneration. This means that individuals who are in receipt of foreign remuneration are permitted to exclude the first R1 million from their taxable income, provided they meet the requirements of section 10(1)(o)(ii). Chapter 5 explained that the definition of "remuneration" is made up of many different types of remuneration, including benefits in kind, which may be provided to an employee who is required to render services abroad. The chapter discussed the concerns raised by various commentators and it is submitted that the key areas of concern relate to the definition of "remuneration" and how the R1 million should be calculated for the purposes of the application of the exemption.

The goal of chapter 6 was to consider the relevant legislation in Australia, the UK and the US, and illustrated how these countries treat foreign employment income for tax purposes. The chapter set out to highlight areas of similarity between the relevant legislation of each of the countries and demonstrate how the issue of double taxation is addressed in each of the respective countries. The analysis of each of the countries established that all residents of these countries are taxed on their world-wide income. Each of the countries has entered into DTAs as a first step in alleviating the risk of double taxation. It is submitted that the relief mechanisms provided by each of the countries is similar to the section 6*quat* credit or rebate method provided for in the Income Tax Act in South Africa. However, the US is the only country that appears to go a step further in respect of foreign employment income and has recognised that foreign income may comprise of additional benefits, such as housing, when an employee is required to render services abroad. The US has therefore provided an additional exemption to exclude this amount from the calculation of taxable foreign income. The UK has also implemented a means to avoid the situation of an individual paying double tax in terms of their PAYE system. This is applicable when an employer has sent an employee to work abroad. The employer will calculate the UK PAYE and compare this to the foreign tax that is required to be paid and the individual will not be required to pay any more tax than he or she would have paid had he or she been taxed only in the UK. While this may create additional administration for the employers, it seeks to ensure that an individual's cash-flow is not adversely affected as a result of paying tax in two jurisdictions and only later claiming a rebate or credit upon assessment.

7.3 FINAL CONCLUSION

The discussion in this thesis illustrates that the key to determining an individual's tax liability in South Africa is to determine their tax residence status. It is evident that each country has its own way to determine tax residency, which may result in a person being resident in more than one state. This has resulted in countries entering into DTAs which assist in allocating taxing rights between two countries where an individual is found to be dual resident. In addition, many countries have introduced some form of domestic tax relief mechanism in respect of foreign income. South Africa's primary relief mechanism is section 6*quat* of the Income Tax Act, which is a credit or rebate method claimed upon assessment in respect of foreign income. In addition, section 10(1)(o) of the Income Tax Act provides relief for foreign employment income.

It is submitted that, when rendering services abroad, both the employer and employee need to consider the tax consequences that may arise. In this regard, section 10(1)(o) of the Income Tax Act, and particularly section 10(1)(o)(ii), are critical. In light of the amendment to section 10(1)(o)(ii), employees will be subject to tax on their foreign employment remuneration in excess of R1 million. As indicated above, the legislation is unclear as to how this R1 million should be calculated. An employer, whose practice is to ensure that their employees are in a tax neutral position as a result of rendering services abroad, will need to consider the additional costs involved as a result of the amendment. Similarly, employees need to consider how their remuneration package is structured. Until further guidance is provided "remuneration" will include a person's salary as well as any benefits provided by an employer, and therefore employees need to calculate whether their total remuneration exceeds the R1 million threshold.

The main goal of the research was to highlight factors that need to be considered by both employers and employees when considering rendering services abroad. Based on the discussions in this thesis it is submitted that these can be summarised as follows:

- Tax residency of the individual, in terms of the domestic legislation, must be established.
- Where individuals are rendering services abroad, are they deemed to be a resident in that foreign state? If so, is there a DTA in place?
- Where there is a DTA in place, the articles of the DTA need to be consulted to establish whether the taxing rights have been allocated to a particular state, determine the residency of the individual or establish whether the DTA has directed tax relief in terms of the domestic legislation of a Contracting State.

- Where services are rendered abroad, do the provisions of section 10(1)(o) of the Income Tax Act apply and, if so, identify which provision is applicable. The person must be an employee and therefore consideration should be given to the employment status of the individual. Independent contractors will not be permitted to apply the exemption.
- Where section 10(1)(o)(ii) of the Income Tax Act is being utilised, does the individual meet the additional requirements in terms of the section:
  - Was the employee outside the Republic of South Africa for a period or periods exceeding 183 full days during any 12-month period; and
  - Was this for a continuous period exceeding 60 full days during that period of 12 months?
- Does a person earn below or above the R1 million threshold?
- In respect of an employer, the employer will need to consider the benefits offered to individuals rendering services abroad and whether this will have the effect of them exceeding the R1 million limit. They will also need to consider any tax equalisation policies, as this may result in additional costs for the employer.

While this list is not exhaustive, it is submitted that these are some of the factors that both an individual and an employer should consider when electing to render services abroad.

It is submitted that, key to making an informed decision, is that the legislator needs to provide guidance on how the R1 million will be calculated. Furthermore, the tax authorities should seek to implement exemptions for larger benefits such as housing, similar to the approach adopted in the US, as this may assist in ensuring that individuals do not exceed the R1 million threshold on the basis of the benefit only. Consideration should also be given to the manner in which PAYE applies. In this regard, the tax authorities could turn to the UK for guidance and adopt an approach similar to Appendix 5 arrangements, therefore assisting in reducing any cashflow issues which may arise as a result of having to pay tax in two jurisdictions in respect of the same income.

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