INTUITION

9 JUNE 2023

Local or Foreign, the tax net is tighter

Recent changes in SARS processes have rendered the moving of funds offshore administratively complex. Several market commentators have indicated that SARS is trying to block funds from leaving South Africa. The press never misses the opportunity for a sensational headline, yet the truth is far removed from that. What the Government is addressing is the historic misaligned processes between tax residency and financial emigration. After all, if they intended to block capital export, then why would they allow emigrants to access the full value of their pension funds and externalize them and why would they allow the biggest savings pool in the country to increase their foreign holdings percentage? It is amusing to the writers that the same people who wish for good management at Eskom are mortified when it arises elsewhere! That said, there is no doubt that the alignment of the processes and the administration required to adhere has, for some, severe implications, and moving money out of the country is going to become significantly more of an administration quagmire and definitely will require squeaky clean tax compliance.

Robin Gibson

Shelley Moreno

Historically you formally emigrated through the South African Reserve Bank (SARB). This was a different process from being a tax resident in another country (where you could be living and working on an extended contract with the intention to return to South Africa at a later point in time). Should you formally emigrate you would have had a blocked account and any assets left here would have to be fed through that account with Reserve Bank permissions. Over time legislation has changed and South Africa moved from a sourced-based taxation regime to a resident-based taxation regime. Financial emigration remained but it was a relic of the past that didn't fit with the updated tax regime. The fiscus mentioned in past budgets that they wished to rationalize these disparate systems and while there was slow evidence of activity in the background the formality hit both tax practitioners and the public in April of this year. The result is a unified process for moving money out of the country whether resident or non-resident (although the limits and tax implications are different for each).

SPEED READ

- **Moving funds out of South Africa is more freely available with the R10 million annual investment allowance and 45% direct offshore exposure limits in pension funds. Even emigrants can export their full pre-retirement capital 3 years after ceasing to be a SA tax resident.**
- **The government indicated some time ago that they wanted to align foreign tax residence and financial emigration into a single process. While ample legislation has been in place for some time to achieve this, April 2023 saw a hard implementation of the process. This is going to prove difficult to stomach for some whose tax affairs are less than squeaky clean.**
- **Future foreign transfers will require the successful application for the Approval for International Transfer (AIT) from which a Tax Compliance Status Pin will be issued. This will require adherence to a set of strict and invasive protocols.**
- **Individuals who have submitted taxes as non-resident taxpayers for many years will be required to submit a plethora of documents to formalize this status in the coming months. This formalized process to register as a non-resident taxpayer will be required as a precursor to any foreign fund transfers.**

Some time ago it was announced that the financial emigration and the foreign tax status would be unified under SARS rather than being separated between SARS and SARB. The press only focused on the introduction of a 3-year waiting period post-tax status change before pension and retirement interests could be exported. The narrative was that the government was trying to stop migrants from accessing their financial assets for up to 3 years after they had left. The truth was completely different. This was merely a rationalization of a system. Make no mistake though, part of the exercise was to ensure the Fiscus received its full due from South Africans residing in other parts of the world.

Why is this important? Your tax residence determines how SARS calculates your tax liability. If you are a South African tax resident you are taxed on your worldwide income (with various exemptions and deductions for taxation paid to the government at source). Should you be a South African tax resident and then migrate to become a non-tax resident then your tax liability will change depending on the local source of any income. As changing tax residency is a deemed capital gains tax event, a capital gains exit tax will have to be calculated. This calculation is based on the growth of the value of your worldwide assets, except for fixed property in South Africa and assets of a permanent establishment ie a business. As this is a deemed sale and not an acutal sale of your worldwide assets, it can give rise to cash flow problems in funding the tax liability. It may also change your status from being a non-provisional taxpayer to a provisional taxpayer for that year. As a non-resident taxpayer, the tax liability to SARS on assets still held in SA and the income they generate would also change.

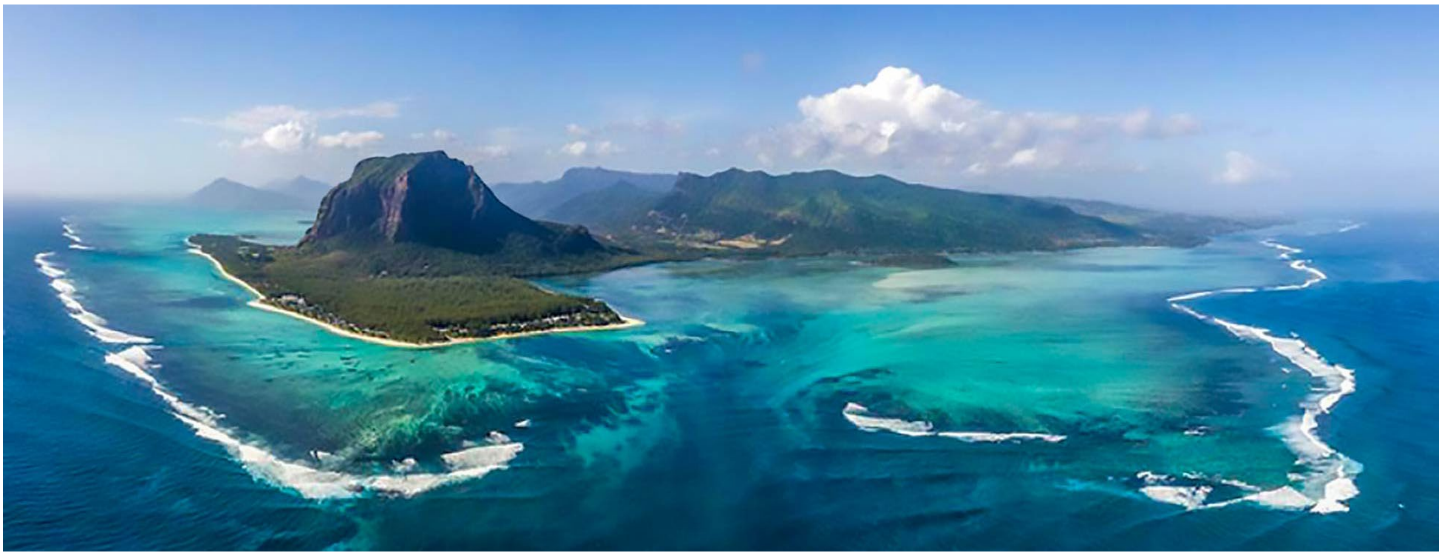
> "South African residents have an annual R1 million discretionary allowance (for travel, gifts, and foreign education among other things) without any compliance procedures."

In addition to the tax on income, tax residency will also determine what foreign cash flow benefits you are entitled to. South African residents have an annual R1 million discretionary allowance (for travel, gifts, and foreign education among other things) without any compliance procedures and an annual R10 million foreign discretionary allowance, subject to application for the AIT and the TCS Pin.

Foreign Tax residents on the other hand do not have access to the discretionary allowance and will be required to obtain an AIT on every Rand taken out of South Africa. The soft limit is R10 million per annum, but in practice, non-residents can make applications to export the full value of any assets sold, revenues earned, or distributions received. Tax withheld is then subject to any Double Tax Agreement (DTA) between SA and their country of residence. As the local fixed property is specifically excluded from the deemed capital gains exit tax calculation, the actual sale will be subject to capital gains tax notwithstanding the deemed residence of the taxpayer.

One may see no value in becoming a non-resident, but we think there are several reasons to formalize your non-residency status with SARS:

1. Your worldwide asset value may have grown as you have earned foreign income and built up an asset base over the years. Wouldn't it be better to do the deemed exit capital gains tax calculation when you ceased to be a resident, as the value of your worldwide assets was probably far less then? Your capital gains calculation all those years ago could be negligible and far harder to



Life in Mauritius may be appealing but SARS will want to have a good chat before you go.

2. If you decide to come back to South Africa, the base cost of your worldwide assets is deemed to be the market value on the date you become a South African tax resident again. So, the increase in capital value from the time you ceased to be tax resident in South Africa to the time you become tax resident again is not taxed, saving you a lot of capital gains tax on the eventual sale of the asset.
3. You may have been overtaxed for all these years declaring yourself as a South African tax resident when in fact you are non-resident. As a non-resident, you only declare your income from a South African source, whereas if you are a South African tax resident you are taxed on your worldwide income. So as a non-resident, you are not taxed on your foreign employment income including fringe benefits, as this income is not from a South African source. In addition, non-residents are not taxed on local interest from a South African bank account if the exemption applies.

"SARS already uses AI in the tax process and only 1 in 10 tax returns are referred to human intervention based on algorithmic criteria."

4. You may wish to transfer pre-retirement assets out of South Africa. An application to be treated as a non-resident may accelerate access to these funds. In many cases, it may be possible to prove that the 3 years have already expired and that funds can be accessed immediately.
5. You might feel that there is little risk to remaining a SA tax resident as you can freely avail of the R1 million Discretionary Allowance without any complicated tax procedures. We would caution that we are seeing that in the age of machine learning and artificial intelligence (AI), the exchange of information across government institutions is increasing. SARS already uses AI in the tax process and only 1 in 10 tax returns are referred to human intervention based on algorithmic criteria. We are certain your travel habits and port entries will in due course flag your status. It would be devastating to discover that you are expecting an imminent payment, only for SARS to indicate that you should be formalizing your non-resident status before the funds flow.

So what is involved? To prove your tax status as a non-resident taxpayer on the SARS system, taxpayers will be required to provide substantial documentary proof as specifically requested by SARS and show the final capital gains exit tax has been calculated and any tax liability paid. This is where some danger lies. Should it become apparent that the taxpayer should have applied the process earlier and paid an exit tax, then penalties and interest could be raised. This could leave taxpayers with a rude shock, not to mention a substantially dented wallet!

So when should you process a change to your residency from a tax perspective? The flow diagram at the end of this document gives a clear indication of your status, and we will include a link to the section of SARS's website to access the necessary DTAs. In essence, you cease to be a South African tax resident and are considered non-resident when

1. You can prove to SARS that you ceased to be ordinarily resident in the Republic because your intention changed at a specific point in time and you actively took steps to make a foreign country your real home; or
2. You are no longer a deemed South African resident in that you fail the physical presence test because you have not spent the required number of days in South Africa over 6 years. Alternatively, you may have fulfilled the requirements of the physical presence test in that you have spent the required number of days in South Africa, but if you then leave South Africa and do not return for at least 330 full days after the date you left, you will be considered non-resident from the day after you left SA; or
3. You are considered to be exclusively a resident of another country by application of the Double Taxation Agreement (DTA) between South Africa and the foreign country. This applies when a taxpayer is considered a dual resident for tax purposes. As a taxpayer can only be a tax resident in one country at a time, the tie-breaker rules in the relevant DTA will determine which country must give up taxing rights.

Taxpayers who are not residents in terms of these guidelines yet who do not formalize their residency run the risk of being taxed on their worldwide income. The process is onerous and administratively complex. We would encourage taxpayers to whom this applies to regularize their affairs as a matter of urgency or seek advice as a matter of some importance. We have performed a number of these applications and while not particularly a cheap exercise, we have been able to charge a competitive rate relative to other service providers in the industry.

SA Double Tax Agreements (DTAs) may be found at the following address on the SARS website:

https://www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/

This test is to be done **annually** and is only applicable to a person who is **not** at any time during the relevant year of assessment **ordinarily resident** in the Republic.

Is the person deemed to be exclusively a resident of another country for purposes of the relevant double taxation treaty?

Yes

No

Was the person physically present in the Republic for a period or periods **exceeding 91 days** in aggregate during the relevant year of assessment?

No

Yes

Was the person physically present in the Republic for a period or periods **exceeding 91 days** in aggregate during each of the 5 years preceding the relevant year of assessment?

No

Yes

Was that person physically present in the Republic for a period or periods **exceeding 915 days** in aggregate during the preceding 5 years of assessment?

No

Yes

IMPORTANT

A day shall:

include a part of a day but;

exclude any day the person is in transit through the Republic

between two places outside the Republic **and**

that person not formally enters the Republic through a "port of entry".

Was the person, who is a **resident** in terms of the **physical presence test**, physically **outside the Republic** for a **continuous period** of at least 330 full days after the day on which he/she ceases to be physically present in the Republic (which may stretch over two consecutive years of assessment)?

Yes

No

that person is **deemed not to be a resident** as **from the commencement date of the 330-day period** which commenced the day after the day on which he/she left the Republic.

that person still remains a resident up to the last day of the previous year

NOT A RESIDENT

RESIDENT

As from the commencement date of the year of assessment which as 1 March each year.

Our next Insight seminar will take place in June and provide an update on what has driven markets over the first six months of the year, and what might lie ahead for the balance of the year. We are very excited to be expanding our seminar program to Cape Town.

[Harvard House is on Facebook]

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Topic:	Mid Year Market Update
Natal Midlands	
Date:	Thursday, 22nd June 2023
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	Tuesday, 13th of June
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	Wednesday, 14th of June
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

CONTACT DETAILS:

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