

GMS Flash Alert

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South Africa – Proposed Repeal of the Foreign Services Exemption

The 2017 Draft Taxation Laws Amendment Bill, dated 19 July 2017, proposes to repeal the private-sector foreign employment income tax exemption for South African residents as of 1 March 2019.

This proposed change is described below.

WHY THIS MATTERS

For assignments to South Africa in which assignees are subject to South African taxation, and for assignees working outside South Africa but still subject to South African taxation, international assignment cost projections and budgeting should reflect the draft changes described in this newsletter if and when they come into effect. Where appropriate, adjustments to gross-up packages and withholding taxes need to be considered.

Current Legislation

South African tax residents are taxed on their worldwide income under the residence-based system of taxation. Whilst double taxation treaties (DTAs) exist to prevent double taxation under certain circumstances, specific provisions in the South African tax legislation provide pre-emptive exemptions, e.g. an exemption that limits a country's taxing rights statutorily based on certain criteria.

Many South African tax residents work abroad for a period during their working life. At present, section 10(1)(o)(ii) of the Income Tax Act, No. 58 of 1962 (ITA) exempts employment income received by a South African tax resident during any year of assessment for services rendered outside South Africa for or on behalf of any employer, if that individual was outside South Africa for:

- a period or periods exceeding 183 full days in aggregate during any 12-month period; and
- a continuous period exceeding 60 full days during that 12-month period.

The exemption is only available to employees of private-sector companies.

KPMG NOTE

There is currently no requirement that tax be payable in another country for this exemption to apply. As a result, it is possible that under certain circumstances, no income tax will be paid anywhere by South African tax residents, for periods worked outside of South Africa.

Furthermore, because there is no requirement that tax be payable in another country for this exemption to apply, individuals often do not have to rely on DTAs or make use of the tax credit system to avoid double taxation.

Proposed Amendment

According to National Treasury, the exemption for private-sector foreign employment income from the South African tax net appears excessively generous, particularly in instances where the individual worked in a foreign country with a low or zero personal income tax rate. National Treasury is of the view that the current exemption creates opportunities for double non-taxation and unequal tax treatment for South African residents employed by a national, provincial or local sphere of government or any public or municipal entity, who thus do not qualify for the exemption.

It is proposed that the exemption be repealed, resulting in all South African tax residents being subject to tax on foreign employment income earned for services rendered outside South Africa with relief from foreign taxes paid on the income under section 6quat of the ITA.

The effective date of the proposed amendment is 1 March 2019 and applies to years of assessment commencing on or after that date.

KPMG NOTE

Outside of pre-emptive exemptions, relief from double taxation is currently available to individuals who:

- rely on a DTA to seek relief from having to pay tax in South Africa on certain foreign- sourced income; or
- claim foreign tax credits (under section 6quat of the ITA) for taxes already paid in the foreign country relating to the foreign-sourced income.

The application of a DTA is fairly complex and often requires an individual to seek tax advice. If there is no DTA between South Africa and a particular foreign country or the DTA does not provide exclusive taxing rights, the individual will have to rely on claiming foreign tax credits to prevent double taxation. The ITA section 6quat rebate is limited to the amount of tax the individual would have paid had the income been earned in South Africa.

Individuals claiming relief through the use of foreign tax credits can only do so when they submit their own tax returns. Until that point, the individual must still pay all taxes due in both affected countries. It is evident that without an administrative intervention, a cash flow problem could occur when tax is due and payable on a monthly basis in the foreign country. A further complication is the difficulty in providing sufficient proof of foreign taxes paid. Certain self-assessment taxes do not require assessment from the revenue authorities and the only proof that the individual would have of taxes paid would be a foreign tax return. In addition, tax years that are not aligned cause complexity in calculating the credits available.

The proposal has the potential to result in a tax withholding of up to 90% of taxable income in certain circumstances. Clearly, this would be a harsh result.

KPMG NOTE: NEXT STEPS

While certain proposals mentioned in the Budget 2017 are in the process of being enacted, there is still an extensive legislative process before any changes are made to the tax exemption for foreign service income.

- The draft Taxation Laws Amendment Bill, 2017 (draft TLAB) has been published for public comment prior to its formal introduction in Parliament. The Standing Committee on Finance (SCOF) will convene public hearings on the draft TLAB before its formal introduction in Parliament. National Treasury and South African Revenue Service (SARS) have invited written comments on the draft TLAB with a due date of 18 August 2017.
- Subsequently, National Treasury and SARS will engage stakeholders submitting comments through workshops to be held in late August 2017, if the written comments require greater detail or more information. Afterwards, around the end of September 2017, a response document providing written responses on comments received will be presented to the SCOF. The draft TLAB will then be revised, taking into account public comments, before it is introduced in the National Assembly and formally considered by the SCOF, and thereafter the Select Committee on Finance in the National Council of Provinces.
- The draft legislation and the draft explanatory memorandum containing a comprehensive description of the draft amendments can be found on the National Treasury (www.treasury.gov.za) and SARS (www.sars.gov.za) websites.

KPMG in its own name, and in conjunction with industry bodies, will engage with National Treasury and the Parliamentary committees as part of the legislative process. We would welcome any discussions on the effect of this proposal on clients.

Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in South Africa:



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