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GMS Flash Alert

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South Africa - "Less Obvious" Consequences of Foreign Earnings Exemption Cap

Beginning 1 March 2020, the legislative cap to South Africa's foreign earnings exemption goes into effect. The change will limit the application of the exemption to the first ZAR 1 million of income for employment services rendered outside South Africa for a year of assessment.[1] Much has been said about how the change will impact individuals' tax liability for foreign employment income. (For prior coverage, see GMS *Flash Alert* 2019-083 (April 26, 2019).)

This GMS *Flash Alert* explores some of the other, less obvious consequences of the changes.

WHY THIS MATTERS

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

While many employers with a mobile workforce have policies in place to protect employees from the adverse tax implications of their temporary assignments, the application of these policies are generally limited to income from employment. Therefore, employers that do not offer protection on personal income should make their employees aware of how the changes might impact them. Employers that do have protection for employees' other income need to consider the additional costs they will incur in this regard.

Income from Other Sources

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

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

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

Example

An individual earns income for foreign services of ZAR 2 million per annum and taxable South African-sourced rental income of ZAR 150,000 per annum. The individual fully meets the requirements to qualify for the foreign remuneration exemption. A tax credit of the full value of South African tax due on the foreign employment income is available.

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

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

Capital Gains Tax

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

Compliance Obligations

The definition of "provisional taxpayer," set out in the foreign earnings exemption,[2] includes any person who derives income by way of remuneration from an employer that is not registered for South African employees' tax. A person who

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does not derive income from carrying on any business and whose taxable income is less than the tax threshold would be excluded from the definition.

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

Following the amendment, individuals will not be excluded to the extent that they have taxable income in excess of the tax threshold as a result of the reduced application of the exemption.

FOOTNOTES:

1 Under section 10(1)(o)(ii) of the Income Tax Act, No 58 of 1962, foreign remuneration earned by a South African resident taxpayer was not subject to South African income tax if the taxpayer has spent over 183 days working outside of South Africa. South Africa's Taxation Laws Amendment Act, No. 17 of 2017 (18 December 2017), amended the law to cap the private-sector foreign employment income tax exemption to ZAR 1 million for foreign-earned remuneration as of 1 March 2020.

2 Paragraph 1 of the Fourth Schedule to the Income Tax Act of 1962.

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RELATED ARTICLE

This article is excerpted, with permission, from "The 'not so obvious' consequences of the changes to the foreign earnings exemptions," in *Tax Alert* (May 2019), a publication of the KPMG International member firm in South Africa.

ZAR 1 = EUR 0.062

ZAR 1 = USD 0.069

ZAR 1 = INR 4.82

ZAR 1 = GBP 0.055

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