Glacier Tax Workshop 2021

The Glacier Tax Workshop 2021, held online on 27 May, was attended by around 900 intermediaries who got to hear first hand from Diane Seccombe, Head of Tax Training at Mazars, around the latest tax changes.

Diane Seccombe fielding audience questions asked by Kritz Coetzee, Regional Manager: South at Glacier by Sanlam.

Below we provide a brief summary of some of the elements discussed in this session.

Resources

[Access the tax workbook]
[Review the workshop Q&A document]
[Glacier Tax Guide 2021-2022]

Webinar Recording

[Webinar recording - Session 01]
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Workshop Contents

1. A focus on compliance

In this year's Budget Speech, the Minister of Finance spoke on "closing SA's tax gap". Essentially, SA is trying to stave off increasing tax rates by focusing more on compliance.

The South African Revenue Service (SARS) has shifted their focus so that the compliant taxpayer receives a professional experience in their dealings with SARS. The focus is therefore on the genuinely non-compliant taxpayer, specifically around offshore income and offshore assets not being declared.

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2. Retirement funds

Nothing has changed in respect of the retirement fund lump sum tables i.e. the retirement/ retrenchment/ death and withdrawal tables. When an emigration is going to entitle someone to withdraw monies from either a preservation fund or retirement annuity fund, remember that any withdrawal other than *retiring* from the fund, will be taxed according to the withdrawal lump sum table – which is the most punitive of the two tables.

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3. Tax residence

If someone is tax resident in SA, it means that SA will tax the individual on their worldwide income. SARS is now starting to understand how much non-disclosure there's been over the years. It's important to understand that you can have money in a foreign bank account, never repatriate it but still have to pay tax on that amount. If you're SA tax resident, you'll be taxed on this.

As a tax resident, your capital gains tax (CGT) is also taxed on a worldwide basis. If you dispose of assets - local or worldwide – then SA can tax you on the CGT. It's critical to understand where you're tax resident.

Any amounts earned – local or foreign – must be disclosed. However, if you're non-resident, then different rules apply. In general, you'll only be taxed on amounts earned from an SA source.

If a taxpayer is non-resident, then they need to work out what amounts are earned from an SA source, or are generated by any activity or asset in SA. Non-residents are required to submit a tax return for all their taxable income from an SA source. The moment a taxpayer becomes non-resident for tax purposes, their overall taxable amount should be lower as they are likely to have less SA source income than they had taxable income as a tax resident. If this same taxpayer continues to contribute to an SA retirement fund, they can then still deduct contributions up to 27.5% of their income for tax deduction purposes. Even if the taxpayer leaves SA, there is still good reason to continue contributing to an SA retirement fund.

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No more financial emigration

There is no more financial emigration. It's therefore critically important for investors to regularise their tax residence with SARS. If tax residency is not reflected in the SARS system correctly, an individual might not get the clearance needed to move money out of the country.

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Where is an individual tax resident?

Tax residence is purely a tax issue – it has nothing to do with citizenship, visas or passports, or even where the person lives.

So, where is an individual *tax* resident? The Income Tax Act (ITA) provides a definition of resident. If the individual is *ordinarily* resident in SA, then SA is where that person is tax resident.

Ordinarily resident is more than just where the person physically resides. SARS' Interpretation Note 3 states that in order to decide where a person is ordinarily resident, there is no one-size-fits-all test. SARS looks at a number of factors around people's lives, e.g. the country of their main home, their intention, habitual abode, place of business, church, schools, where their spouse resides etc. It then becomes easier to see what they regard as their principle or main home.

It's possible to live outside of SA for a number of years, but because of these other factors, SA still shows itself as the person's true or main home. An individual can still, for tax purposes, be ordinarily resident and classified as tax resident. There are many people working around the world in this situation.

Where the ordinarily resident test fails, the second test for physical presence needs to be applied.

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Double taxation agreements

If an individual has worldwide income and worldwide assets, the Income Tax Act says that an exception is allowed if a double taxation agreement (DTA) finds the person tax resident in another country. If this is the case, then the DTA overrides their tax residence determined by jurisdictional law.

It's possible to be ordinarily resident in SA and to look like you're tax resident here but at the same time be tax resident in another country. Where this happens the tie-breaker rules in the applicable DTA will determine the residence status for the purposes of the DTA. A person can only be tax resident in one country. This is referred to as a treaty residence. SA has to accept the individual as tax resident in the other country, and as a non-tax resident here. SA can then only tax the individual on the disposal of immovable property.

Looking at the Estate Duty Act – if the individual is ordinarily resident in SA, then for estate duty purposes their worldwide assets fall into their estate.

There is a DTA for every single country, and they're all different. These can be found on the SARS website: at the top of screen, select the black tab labeled Legal Counsel, click on the link in the new page that opens up – called International tax treaties. This page breaks up treaties between those with Africa and those with the rest of the world.

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Expat tax

Previously, an SA tax resident could earn offshore income tax free in SA due to the workings of the Section 10(1)(o)(ii) exemption. This was subject to the individual being out of SA for 183 days (of which 60 days were continuous) in a 12-month period.

This has changed. Now, not all worldwide earnings are tax free. If an SA tax resident meets the requirements, they only have R1 250 000 as a tax-free amount on foreign earnings.

Let's look at an example - Mr Dubai:

Mr Dubai has been working in Dubai for the past five years. In the first year he was there, the DTA would already have had him resident to Dubai for tax, and as non-resident here. His circumstances have not changed over last five years.

When we now look at his SA gross income, he is non-resident for our ITA and can only be taxed on SA sourced amounts and for employment income only on amounts earned in SA. He is in Dubai, therefore the source of his employment income is Dubai and not SA. He is non-resident here in terms of the DTA and has been for nearly four years. His foreign earnings can't be included in his gross income.

For people who have been working outside SA for many years, and are tax resident outside of SA, although many are still ordinarily resident here, the DTA with the relevant country had broken their tax residence, and therefore foreign income and dividends could not be included in their SA gross income. The exemption is not needed because the individual is non-resident in terms of the DTA. However, because they're ordinarily resident here, estate duty will still apply.

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What are the consequences of breaking tax residence?

A deemed disposal of assets

When a natural person ceases to be a resident, that person is deemed to have disposed of all their assets at market value on the day before that person ceases to be a resident and reacquired all those assets at an expenditure equal to that same market value on the day that person ceases to be a resident. This could trigger either a capital or a revenue gain. Subsection 9H(7) stipulates that the market value of such assets reacquired will be in the same currency in which the assets were originally acquired.

One asset that is excluded from section 9H's deemed disposal of qualifying assets is SA immovable property. If an individual should cease being tax resident, their immovable property here is not part of the deemed disposal. Personal use assets, including any interest in retirement funds and local SA insurer life policies, are also excluded (but not foreign policies). But share portfolios, unit trusts, and cryptocurrency do form part of qualifying assets. Any immovable property *outside* of SA will still form part of the deemed disposal, as will worldwide assets.

Example: When Mr Dubai above is completing his tax in the 2021 tax year, he has been working in Dubai for five years, and his wife and children are in SA. He would have broken tax residence in his first year of working in Dubai, i.e. 2017. The DTA automatically applies from that date – not when he becomes aware of it.

Cryptocurrency is an asset and can also present a tax consequence arising from the deemed disposal.

If an asset forms part of a deemed disposal, we still need to consider what type of asset it is. In other words, if the individual is actively trading in a share portfolio, and they cease being resident here and Section 9H deems a disposal of that portfolio – they will have the consequence of a disposal of stock. The same holds true for cryptocurrency. If you trade and cease being resident, it will be a deemed disposal of stock.

SARS will therefore look at what qualifying assets you owned, how they were held, and whether they will be deemed disposal of stock or capital assets.

Many taxpayers are realising assets, for example selling holiday homes they can no longer afford. Some are realising one asset class in favour of another. There are many people who, for the first time, are disposing of capital assets and incurring capital gains. If an individual is emigrating and breaking tax residence, that is a capital gain (from the deeming provision).

But if we consider people who are staying – many are selling assets for various reasons. Many of these people are in employment and would never have registered as provisional taxpayers. If that same tax payer has disposed of assets and incurred a taxable gain during a tax year – there's a real chance a taxable gain is used to calculate a second provisional payment and a chance the person will have to register for provisional tax and submit a provisional tax payment to SARS by the end of the tax year in which the assets were disposed. If payment is not received, there will be a 20% understatement penalty and interest on the late payment.

If there has been a disposal of capital assets during the year, including deemed disposals, it's important to check whether the client needs to register as a provisional taxpayer. If they are already a provisional taxpayer, check to see if they owe anything and by when.

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Other consequences of changing residence

When a person breaks tax residence either due to a DTA or because they're no longer ordinarily resident here – they have to regularise this with SARS. When submitting annual returns, there is a question in the returns that asks whether they ceased being resident during THIS particular year of assessment (if filling out a 2020 tax return).

In the case of Mr Dubai above, who has only just realised that the DTA applies and therefore wants to state that he has not been resident since 2017 – he would have to notify SARS by correspondence. Mr Dubai can't tick the "yes" block in the 2020 return if residence was broken in 2017. SARS has confirmed that they will change this question to read: "Did you break tax residence in any year of assessment" and then provide a drop-down calendar where users can select a year. However, it is unsure exactly when this change will be implemented.

In the case of Mr Dubai above, SARS will go back to that tax year, see what qualifying assets he had, what CGT was relevant, and what provisional tax should have been paid etc. The change noted above is purely an admin change. The consequences still happen in the year of the cessation of residence. Regularisation of one's affairs with SARS is no longer optional.

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4. Financial emigration

Financial emigration was a process whereby forms were filled out and application made to the SARB to financially emigrate. This process was done away with on 1 March 2021.

It's important to note that the only places these concepts are relevant for income tax purposes, is in regard to a retirement annuity, pension preservation fund, and a provident preservation fund. In the past, if an individual wanted to pull all their monies out of a retirement annuity (RA), or preservation fund, the one way to do that was to financially emigrate. This has been replaced with the new three-year rule – once again relevant to retirement annuities, pension preservation and provident preservation funds only.

The new rule states that individuals may now access monies in an RA, pension preservation and provident preservation fund if they can show that on or after 1 March 2021, they have not been tax resident for at least three consecutive and unbroken years. It is important to remember that if doing an emigration withdrawal – before electing to retire, the individual will be taxed according to the withdrawal table (the most punitive).

Let's resume our example of Mr Dubai above who is living in Dubai and is still a member of an RA in SA and is still contributing. He broke tax residence as far back as 2017. He can show he has not been tax resident for three consecutive years, and the DTA has broken his tax residence here. Right now, he could *pull all of his money out of his RA, just by proving he has met the three-year rule.*

As the law reads now, we do not start counting from 1 March 2021.

The fund member bears the onus of proving their non-residence status. The individual will need to approach their fund, and the trustees will then apply to SARS for a directive. SARS will issue the directive for the money to be taken off the RA (using the punitive withdrawal table), the taxpayer must then apply for a TCR01 form – the new emigration tax clearance from SARS. Individuals will be asked what their assets were in the year they ceased being resident, their CGT etc. Once the tax clearance has been provided to the fund and the authorised dealer, the funds can flow out of SA.

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5. Section 11F deductions

Going back to Mr Dubai who has been living in Dubai and broke tax residence in 2017, we know he is non-resident in SA for tax purposes. For income tax purposes he is taxed on a source basis, and none of his foreign income is included in his gross income and therefore his SA taxable income would be very low. He is still contributing to a retirement annuity fund in SA. According to Section 11F, all fund contributions made to an RA, that are not receiving tax deductions (disallowed contributions), are rolled forward into the next tax year. He can now prove to SARS he's been non-resident for three years in a row. Assuming his fund benefit in the RA is R6 million, before any tax on that R6m is calculated, any fund contributions made that were not tax deductible at the time, will be deductible. In other words - don't rush to pull out of your SA RA. Get regularised with SARS. Use your earnings in Dubai to pump money into your SA RA. You won't get a tax deduction immediately, but it could ultimately pay off.

In another example – Mrs A was a member of two funds, one with her employer's pension fund, and the other, a personal RA. She decides to join her family in the UK. She has already done two things – once she reached retirement age, she elected to retire from her pension fund. When she leaves, she is already receiving a compulsory annuity from her pension fund, and she is also a member of an RA. She has not yet elected to retire from the RA. She'll be doing some social work in the UK and earning money. The question is, should she keep contributing to the RA or wait for three years and then pull the money out?

She is already in receipt of a compulsory annuity from the pension fund – this will be paid in rands and converted to pounds. She has built up a sizeable amount of money in the RA fund in SA but doesn't need it yet as she'll be working in the UK. She has very little taxable income in SA. She keeps contributing for three years but can't deduct all the contributions. Under Section 11F, these contributions will be carried forward, and will first be set off against any compulsory annuity she's receiving. A portion of her compulsory annuity will be exempt from tax in SA. After the disallowed contributions have been used up, if there is anything left over, it will be offset against a lump sum coming out of the RA fund.

There are many people outside of SA in this situation. Again, they will see the benefit of their contributions – even if they're not tax deductible in the year the contribution is made. Regularise your clients with SARS - with the new three-year rule, it's important to understand that those decisions must be taken *before* any election to retire.

Back to Mr Dubai – he's able to prove he's not been resident for three years in a row, and in terms of the new rules he could access all the capital in his RA. We need to consider any negative effects, i.e. would this amount be taxed punitively in terms of the withdrawal tables?

In terms of the DTA, he is now tax resident in the UAE and is non-resident to SA. His SA retirement annuity fund - when he proves he's not been tax resident in terms of the DTA for at least three years in a row - is going to be releasing his entire capital of R6m. Because that amount is now being paid from SA where he is non-resident, to Dubai where he is tax resident – we must consider how the amount will be taxed. If that lump sum is paid from SA to a tax resident in the UAE – then according to the DTA agreement we have with the UAE, SA can't tax the lump sum.

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6. Trusts

Another area of non-compliance that SARS is looking at, concerns trusts.

What if the trust beneficiaries have broken tax residence? A person living in Dubai could now be a non-resident beneficiary. A lot of the basic principles still apply if an SA trust has non-resident beneficiaries. SARS will still look at SA gross income to see what they will be paying tax on. If the beneficiaries are receiving amounts from an SA source, this must be disclosed in their SA tax return.

There are many SA trust beneficiaries who are non-resident but not disclosing SA sourced amounts received from the trust.

When beneficiaries are no longer tax resident here, there will come a time when the trust wishes to dispose of its assets and that will trigger a capital gain from the disposal of the SA trust assets.

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7. Crypto Assets

The SARB monitors every flow of money outside of SA and parameters are in place for SARS to detect more easily the buying and selling of cryptocurrencies.

For tax purposes SARS will apply the normal tax rules to this asset. A crypto asset is not a currency and it's clear that there will be tax consequences from the purchasing and disposing of crypto assets.

If the individual is resident for tax purposes, SARS is interested in the worldwide assets. It doesn't matter where the crypto assets are held.

The onus is on taxpayers to declare all cryptocurrency-related taxable income in the tax year in which it is received or accrued. Failure to do so could result in interest and penalties.

Taxpayers who are uncertain about specific transactions involving cryptocurrencies may seek guidance from SARS through channels such as Binding Private Rulings (depending on the nature of the transaction).

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8. Offshore trusts

In order for a trust to be non-resident and to be taxed on SA sourced amounts only:

- The trust must be formed outside of SA, and
- The place of effective management should be in the foreign country, to show that it was formed and managed outside of SA.

Be sure that a non-resident has set the trust up, check who is funding the trust, check that the correct interest rate is charged, and look at the trust beneficiaries. Many foreign trust beneficiaries may still be tax resident here.

There are other ways to make sure that money building up in the trust is taxed within the tax-friendly trust. Make sure that assets are not earning amounts from an SA source. When a trust has income, if the trustees exercise discretion and vest an amount in a beneficiary for tax purposes, that pulls the amount out of the trust and into the hands of the beneficiaries. With an offshore trust you want the trust to be taxed, not the beneficiaries.

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Section 25B(2A) of the Income Tax Act

SARS now has a situation where many people have offshore trusts (non-resident trusts), but the trust beneficiaries are tax resident in SA. Income would typically accumulate in the offshore trust – and therefore nothing is coming back to SA in the form of taxes.

Where offshore trust assets generate an income but there are no vested rights for the beneficiaries, this income does not flow back into SA. The income then becomes after-tax accumulated retained income. Should the beneficiaries receive vested rights in later years, they will be fully taxed on the distribution they get from the offshore trust. It doesn't matter what the amount was originally. What SARS looks at is whether the amount was taxed in the offshore trust, retained in the offshore trust after tax, and when the beneficiary receives the vested right. Section 25B pulls that full amount in as income for the beneficiary.

Taxpayers have tried to find ways to get around this, for example with the use of retirement annuity trusts. A retirement annuity trust is nothing more than an offshore trust, for tax purposes. It's not recognised as a retirement fund for tax purposes and is not tax deductible. The idea is that the trust is a totally discretionary vehicle.

Be wary of the application of section 25B(2A) to these vehicles as well as the implications of the letter of wishes that sometimes form part of the trust deed, as this is a foreign phenomenon in SA.

These vehicles are made to look like fully discretionary vehicles, but they aren't. We anticipate that SARS will ultimately bring these into our tax net.

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