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Emigration: A taxing decision

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Many South Africans are currently in limbo, with applications to emigrate from South Africa (SA) being placed on hold. Others await quantification of the economic impact of COVID-19 before making any relocation decisions. This delay provides us with an opportunity to consider the capital gains tax (CGT) implications of changing your tax residence in the immediate future.

This article will deal solely with a planned emigration, where a taxpayer has made (or is considering making) an application to live permanently in another country.

Principles of tax residence

The concept of tax residence centres mainly on where the taxpayer is "ordinarily resident". The term is not defined in the legislation, however case law has established some important principles. These include that a person is ordinarily resident in the country where they have their principal or real home, the matter is decided on the facts relevant to each taxpayer, and the physical absence or presence in a country is not a decisive factor on its own.

A successful planned emigration is sufficient proof that a taxpayer no longer considers South Africa their principal or real home, is no longer "ordinarily resident" and therefore not tax resident in SA.

Implications of a change in tax residence

A change in tax residence has a substantial impact on tax collection. SARS moves from being able to tax the taxpayer on worldwide income and capital gains from disposal of worldwide assets (residence basis); to only being able to tax amounts sourced in SA and essentially capital gains from the disposal of SA immovable property (source basis). Double tax agreements may further limit SARS's right to tax specific amounts. A taxpayer emigrating will be taxed on a residence basis until the day before the taxpayer ceases being a tax resident and on a source basis from the day the taxpayer ceases being a tax resident. In a planned

emigration the day the taxpayer gets on the plane to leave SA is seen as the day the taxpayer ceases being tax resident. If, for example, a taxpayer boards the plane on 11 November 2019, the taxpayer's final 2020 tax liability will be determined from 1 March 2019 to 10 November 2019 on a residence basis and from 11 November 2019 to 29 February 2020 on a source basis.

Section 9H in the Income Tax Act (ITA) creates an exit tax in the tax year that tax residence changes. The taxpayer is deemed to have disposed of their worldwide assets for an amount equal to the market value of the assets the day before the taxpayer ceased being resident (10 November 2019 in the above example). The market value will be regarded as the proceeds from the disposal and from that the base cost of the asset will be subtracted to calculate a capital gain or loss.

What is excluded?

Certain assets are excluded from the deemed disposal, most notably immovable property in SA. Taxpayers will have to consider all other investments (listed and unlisted shares and unit trusts – local and foreign, Kruggerrands and immovable property outside SA etc.) when tax residence changes. Assets that do not usually attract CGT remain excluded, for example the personal effects of the taxpayer.

The deemed disposal presents a serious cash flow issue. As the taxpayer retains ownership of the relevant assets, no cash is generated by a deemed disposal. Yet the CGT liability triggered must be paid, along with any other tax liabilities before the taxpayer can obtain the necessary tax clearance documentation to emigrate.

Poor market conditions, in SA and abroad, make the actual disposal of investment assets an unwise decision at this time. As a result, emigrating taxpayers are likely to have many assets falling into the deemed disposal provisions. While the same market conditions may also dictate a lower market value of the assets and a lower CGT liability (even a possible capital loss) from the deemed disposal, there is a sting in the tail to this relief.

Further implications

Section 9H further dictates that the taxpayer is deemed to reacquire the relevant assets, at market value on the day the taxpayer ceases being resident (11 November 2019 in the above example) in order to establish a future base cost of the asset for the taxpayer.

For example: on 10 November 2019 the taxpayer owned 1000 shares in X Mine Ltd. The shares were purchased for R80 000 in 2015. On 10 November 2019 the market value of the shares is R150 000. The capital gain arising from the deemed disposal is R70 000 (R150 000 – R80 000). On 11 November 2019 the taxpayer is deemed to reacquire the shares at the same market value, i.e. R150 000. The country the taxpayer emigrates to may also have CGT legislation. Should the taxpayer in 2025 actually dispose of their shares in X Mine Ltd, the base cost that will be used will be R150 000 (the market value at the date of the deemed acquisition), which will be deducted from the amount received from the actual disposal of the shares.

Consider the following scenario:

To understand the sting in the tail, let us consider the following scenario: A taxpayer on emigration, has a deemed disposal of a number of assets. The SA CGT liability may be reduced due to the low market value of some or all of the assets concerned. That same market value sets up a low base cost for the assets going forward. When an asset is actually disposed of in a subsequent tax year, when the markets have recovered, the capital gain will be substantial. The taxpayer may be tax resident in a country with a higher rate of CGT than SA, and/or be in a position where all funds are needed to re-establish a lifestyle or business in the new country.

Sight must also not be lost of immovable property remaining in SA. As the taxpayer will now be taxed on a source basis, should the property be rented out, the rentals will be taxable in SA. When the immovable property is disposed of, the taxpayer will be liable for CGT in SA. To ensure this is paid, the purchaser will have to withhold 7.5% of the selling price for property over R2 million. The non-resident taxpayer will have to submit a tax return to SARS in the year of assessment that the immovable property is sold.

Conclusion

Taxpayers contemplating emigration have to factor in the local and foreign CGT liability both on exiting SA and subsequent sale of assets once in their new country of residence, to ensure asset growth is not negated by excessive taxes.

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