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Explained: South African Tax and exchange control residency

South Africa has a worldwide tax system, which means that tax residents are taxed on their worldwide income, and non-residents are taxed on income derived in South Africa.

Tax residency in South Africa is first a question of ordinary residence, and thereafter of physical presence. A Double Taxation Agreement between South Africa and another country can, however, override these rules.

Although the exchange control emigration regime is due to change, currently South Africans' exchange control residency is unaffected either by ordinary residence or physical presence, and a resident will remain such until a formal emigration application has been approved by the South African Reserve Bank.

Determining your tax residency

Ordinarily resident

Your tax residency in South Africa is determined based on your ordinary residence, often referred to as the 'toothbrush test' – where your toothbrush permanently resides, or where you return to from your wanderings. While your intention is relevant for this test, a court would also look at other factors, such as your lifestyle and your family and economic connections, to determine your tax residency. In such a case, the court will, for example, consider where your children go to school, where your gym membership is, where your belongings are stored, etc.

By way of illustration, the court had to determine the tax residency of a taxpayer who was sent on a 14-month assignment in the US by his South African employer. The purpose of the assignment was to obtain experience to be applied in South Africa. The taxpayer retained his house in South Africa, which he rented out for the exact period of his overseas assignment. The court also considered that, while his wife and children accompanied him to the US, his parents remained in South Africa, his permanent employment was in South Africa, and he had bank accounts in South Africa. Although he entertained the possibility of remaining overseas, there was no definite decision in this regard. The court thus determined that South Africa was his place of ordinary residence. (1)

In another case, the taxpayer decided to emigrate to the US and moved there after obtaining a permanent residence permit. The taxpayer and his wife established a home and office in the US, joined a local church, opened bank accounts, bought a car and registered for social security. Their children remained in SA to complete their schooling whereafter they joined their parents in the US. When permitted, the family became US citizens. Under the exchange control regulations of the time, the taxpayer had to retain substantial assets in SA, including his family home in Llandudno. During the 31 month period under review, the taxpayer spent on average one-third of his time in SA. The court considered the relevant factors and decided that the taxpayer's 'real home' was the US, and that, consequently, he was not ordinarily resident in SA. (2)

Physical presence resident

Even if you are not ordinarily resident in SA, you can still be a South African tax resident based on your physical presence. A person who is a tax non-resident in terms of the ordinary residence test will be tax resident in South Africa if he has spent a certain number of days in South Africa:

- More than 91 days in total in each of the current and previous five tax years (the days need not be consecutive); and
- More than 915 days in total during the previous five tax years.

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(1) - ITC 1170 (1971) 34 SATC 76 (C). See a summary and discussion in the SARS Interpretation Note 4.

(2) - Commissioner for Inland Revenue v Kuttel 1992 (3) SA 242 (A), 54 SATC 298. See a summary and discussion in the SARS Interpretation Note 4.

A few important points to note:

- Because the physical presence test is a 5-year test, a person can only become SA tax resident in terms of this test in year 6.
- A person who ceases to be a resident during a tax year (for example on the ordinary residence test) and then returns to South Africa in the following tax year, will once again be resident if he meets the requirements of the physical presence test in that next year.
- Nevertheless, a natural person cannot be resident under the physical presence test in the same year that he ceases to be ordinarily resident.
- When a natural person who is tax resident in SA based on their physical presence remains outside SA for a continuous period of at least 330 full days, he will cease to be resident on the day he left South Africa.

The following example illustrates the interaction between these rules:

*Ben is ordinarily resident in South Africa and thus an SA tax resident. He emigrates from South Africa in December 2019 and **becomes non-tax resident in the 2020 tax year** (on the day that he leaves in December 2019). Due to various family and business obligations, Ben spends more than 91 days in SA during the 2021 tax year. Because he also spent more than 91 days in SA in each of the previous 5 tax years and more than 915 days in total during the last 5 tax years, **he is again tax resident in South Africa from the first day of the 2021 tax year**, based on the physical presence test. Let's say in the 2022 tax year Ben spends a continuous period of 330 full days outside of South Africa; **he will again cease to be tax resident in South Africa in the 2022 tax year** on the first of the 330 days.*

For the period from December 2019 to 28 February 2020 Ben would have been tax non-resident in SA, even though he met the physical presence test requirement in the 2020 tax year. This is because he cannot be resident on the physical presence test in the same year in which he ceased to be ordinarily resident.

Tax treaty resident

A natural person who meets the ordinary residence test or the physical presence test, will not be South African tax resident if, notwithstanding having met those tests, he is held to be exclusively a resident of a country other than South Africa under any double taxation agreement ('DTA') tax treaty.

Where a person is tax resident in two countries at the same time according to the countries' own rules, the DTA provides a tie-breaker test. The tie-breaker test is relatively standard, and usually provides that a person will be deemed to be resident solely in the country-

a) where a permanent home is available to him; or

b) if a permanent home is available to him in both countries, then the country where the person's centre of vital interests is; or

c) if his centre of vital interests is not determinative, then the country in which the individual has an habitual abode; or

d) if he has an habitual abode in both or neither, then the country of which the individual is a national; or

e) if he is a national of both or neither country, then the competent authorities of both countries will settle the question by mutual agreement.

Let's take Ben as an example again:

Ben emigrated from SA in December 2019 to the US as he won the Green Card lottery. He is now a tax resident in the US in terms of their rules, and tax non-resident in SA as he ceased to be ordinarily resident in SA (in December 2019). In 2020 Ben spends more than 91 days in SA due to various family and business obligations. Because Ben also meets the other requirements of the physical presence test in SA, Ben is again a South African tax resident in the 2020 tax year. Ben is however tax resident in the US at the same time, based on their rules. Ben would now apply the tie-breaker test of the DTA between SA and the US to determine in which country he is exclusively tax resident. As soon as Ben can satisfy one of the tie-breaker tests, his tax residency is determined and the further tests are not considered.

See the diagrams on page 4-5 to help you determine your SA tax residency.

Becoming tax non-resident: the implications

On the day before you cease to be a tax resident in SA, you are deemed to have disposed of your worldwide assets. This deemed disposal triggers a potential capital gains tax on the unrealised capital gain - the growth - of your worldwide assets, often referred to as an 'exit charge'. Certain assets are excluded from the deemed disposal, such as immovable property in SA and your retirement funds. The maximum effective capital gains tax rate for an individual is currently 18%. The annual tax return contains a tick-box to indicate whether you became tax non-resident during the relevant tax year.

The effect of the exit charge is that you will potentially have to pay 18% on the growth of your worldwide capital assets (certain assets excluded). As this gain is unrealised (you haven't actually sold your assets), the exit charge can be problematic in terms of cashflow.

Your tax year will end on the day immediately before you cease to be tax resident in South Africa. This means that, if you are a provisional taxpayer, you will have to submit a 'year-end' provisional return on the day before you become a non-tax resident.

It is important to remember that, just because you are tax non-resident in South Africa, it does not mean you no longer have any SA tax compliance obligations. Certain SA sourced income, such as rental income, will still need to be declared annually to SARS.

Becoming non-resident for exchange control

Your exchange control residency remains unchanged until a formal application for emigration is approved with the South African Reserve Bank (SARB). A person who is born in South Africa or who has a South African ID is an exchange control resident. SARB imposes many restrictions on the cashflow of exchange control residents. The benefits to emigrating for exchange control include access to inheritances received abroad or in SA.

However, emigrating for exchange control can have many implications, such as the requirement to have your SA shares endorsed as a non-resident shareholder, 'blocking' of certain distributions from SA trusts, and placing the assets that will remain in SA under the control of your SA bank. Due to the potential implications of exchange control emigration, it is wise to obtain expert advice to help you plan your emigration.

The exchange control emigratrion process is due to change and we are awaiting further information. It has been proposed that access to retirement funds will no longer be dependent on exchange control residency status, but on tax residency. For more information see our article on the proposed changes

Should you return to South Africa as a resident within 5 years of emigrating for exchange control, your exchange control emigration will have failed. The means that you will be treated as if you did not emigrate and any assets that you took out of South Africa under the emigration application will have to be repatriated to South Africa.

Special considerations

Special consideration should be given to matters such as a family business or family trust when planning your emigration. The capital gains tax triggered on the family business shares upon becoming tax non-resident is often problematic from a cashflow point of view and requires careful advance planning.

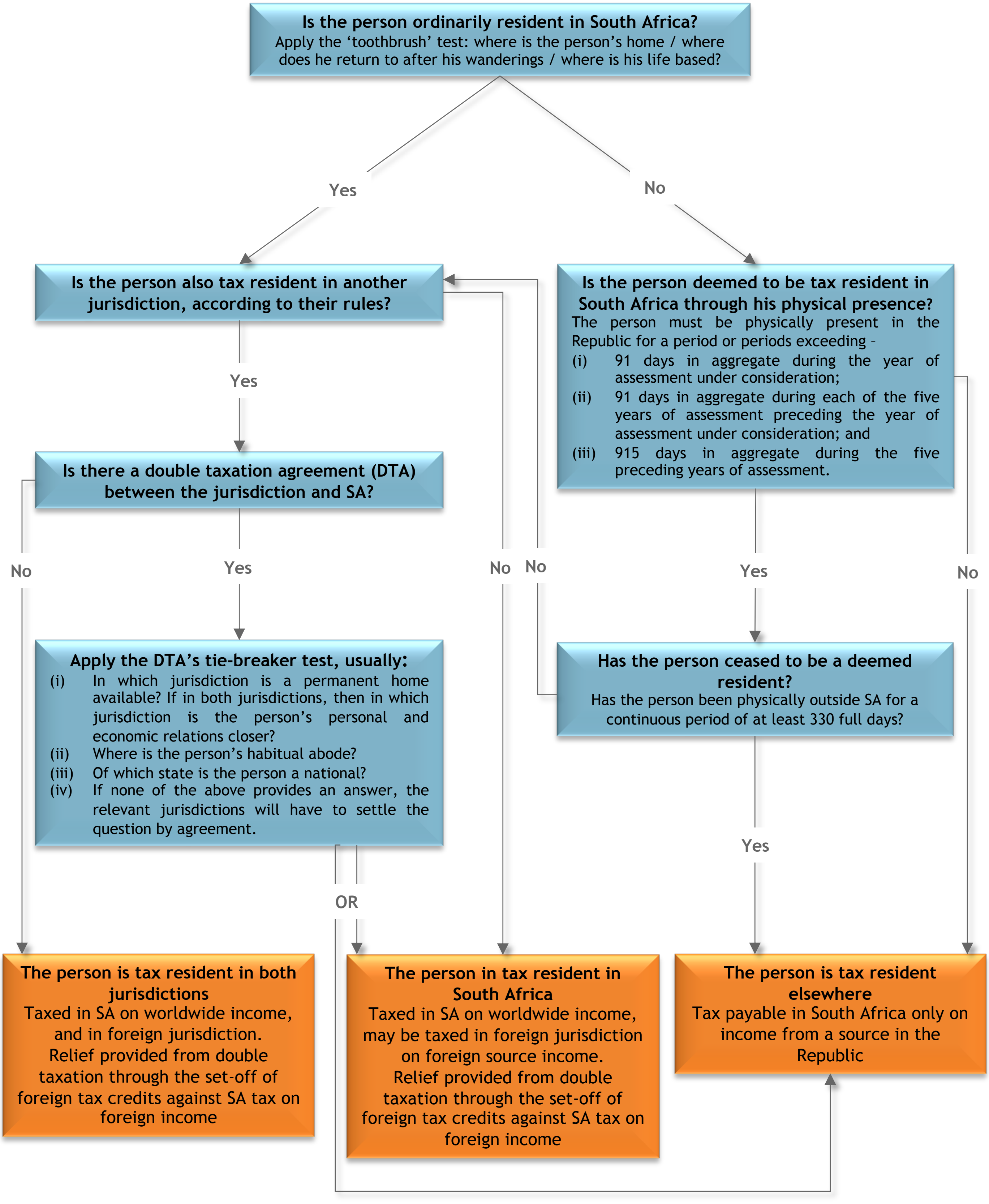
Access to the assets of a family trust can also become complicated after emigrating for exchange control, and the effective tax of the trust could be effected by whether the beneficiaries are South African tax resident. The tax rate of a trust is higher than that of an individual, but a South African trust can make use of the 'conduit' or flow-through principle to pass the tax liability on income or capital gains to a beneficiary through distribution, thereby having the income taxed at a lower rate. However, this is only possible where the trust can distribute the income to a South African tax resident. Once the trust has no more South African tax resident beneficiaries, all the income and capital gains in the trust are taxed at the trust's tax rate, comparable to the highest marginal tax rate for individuals.

Conclusion

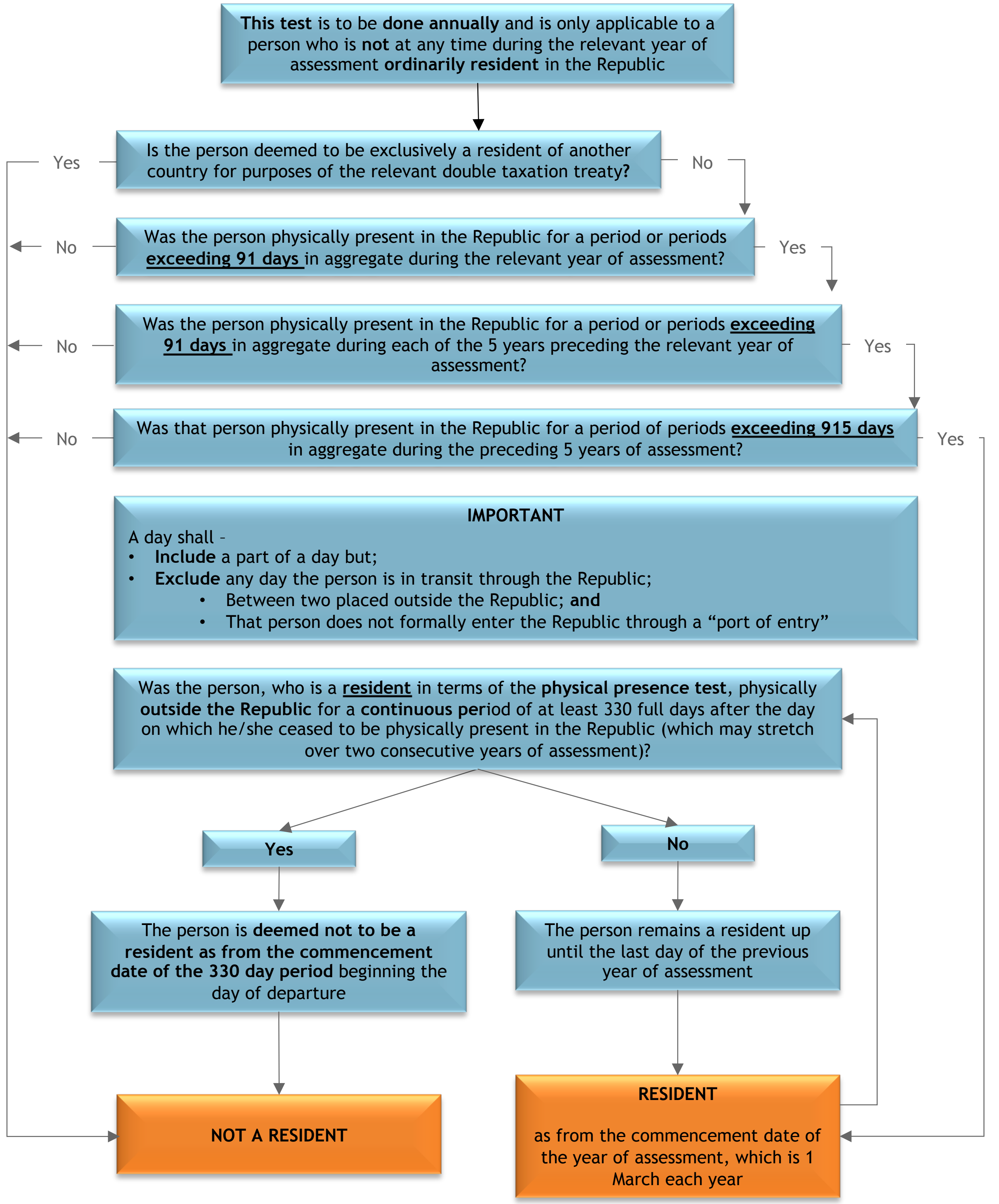
Planning to emigrate can become complicated, but the process can be eased with the right advisors by your side. Make sure to contact a professional advisor as early as possible in the process when you start to consider emigrating from South Africa, especially where family businesses or trusts are involved.

See our diagrams on the following pages to help you determine your tax residency:

ANNEXURE A:
SOUTH AFRICAN TAX RESIDENCY



ANNEXURE B:
ANNEXURE B TO SARS'S INTERPRETATION NOTE 4:
PHYSICAL PRESENCE TEST DIAGRAM



About Hatstone

Hatstone is a multi-jurisdictional group providing legal, investment fund administration, fiduciary and corporate services with offices in the British Virgin Islands, Jersey, London, Panama and South Africa.

Our philosophy revolves around a Director/Partner-led client service and being your trusted advisors.
We believe that the right people will attract the best work and we have put in place a first class and responsive team to assist you.

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