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TAX AND EXCHANGE CONTROL ALERT

IN THIS ISSUE

A MATTER OF INTEREST: RECENT SARS RULING REGARDING INTEREST ON LATE PAYMENT OF BENEFITS

The Second Schedule to the Income Tax Act, No 58 of 1962 (Act) (Second Schedule), deals with the computation of gross income that a person receives by way of lump sum benefits. On 23 May 2017, the South African Revenue Service (SARS) released Issue Two of Binding General Ruling 31 (BGR 31), with the intention of providing clarity as to when an amount constitutes interest, as opposed to forming part of the lump sum benefit, for purposes of the Second Schedule.

FOREIGN EMPLOYMENT INCOME, FOREIGN EMPLOYEES AND EMPLOYEES' TAX – SOME IMPORTANT CONSIDERATIONS

In the 2017 Budget, the Minister of Finance announced that the exemption for foreign employment income that is currently provided for in terms of s10(1)(o) of the Income Tax Act, No 58 of 1962, would be reviewed and potentially amended. We reported on this in our Special Edition Budget Speech Tax and Exchange Control Alert on 22 February 2017.

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A MATTER OF INTEREST: RECENT SARS RULING REGARDING INTEREST ON LATE PAYMENT OF BENEFITS

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The Second Schedule to the Income Tax Act, No 58 of 1962 (Act) (Second Schedule), deals with the computation of gross income that a person receives by way of lump sum benefits. On 23 May 2017, the South African Revenue Service (SARS) released Issue Two of Binding General Ruling 31 (BGR 31), with the intention of providing clarity as to when an amount constitutes interest, as opposed to forming part of the lump sum benefit, for purposes of the Second Schedule.

Retirement benefits and withdrawal benefits are taxed at a lower rate than the rates that apply to a person's normal taxable income.

BGR 31 states that different practices currently exist in the retirement fund industry relating to the late payment of a lump sum benefit. Some fund administrators include this amount to form part of the lump sum benefit payable to a member, whereas other administrators pay the amount separately to the member as interest.

Legal framework

In terms of paragraph 1 of the Second Schedule, a "lump sum benefit" includes the following:

- any amount determined in respect of the conversion of an annuity or portion of an annuity payable by or provided in consequence of membership or past membership of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund; and
- any fixed or ascertainable amount (other than an annuity) payable by or provided in consequence of membership or past membership of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund.

The above amounts will constitute a lump sum benefit whether paid in one amount or in instalments, but does not include any amount deemed to be income accrued to a person in terms of s7(11) of the Act. Section 7(11) relates to amounts paid out of the fund to the person's spouse on divorce.

Lump sum benefits can take the form of a retirement fund lump sum benefit (retirement benefit) or a retirement fund lump sum withdrawal benefit (withdrawal benefit). Separate tax rates apply to amounts received as retirement benefits and amounts received as withdrawal benefits. In terms of s1 of the Act, any retirement benefit or withdrawal benefit must be included in a person's gross income, in terms of paragraph (e) of the "gross income" definition. Paragraph 2(1)(b) of the Second Schedule states that a withdrawal benefit includes, among others, any amount that is transferred for the benefit of a person to any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund from any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund of which that person is or previously was a member. In terms of paragraph 2(2) of the Second Schedule, the amount transferred is deemed to accrue on the date of its transfer.

However, retirement benefits and withdrawal benefits are taxed at a lower rate than the rates that apply to a person's normal taxable income. For example, for the 2018 year of assessment, any withdrawal benefits between R25,000

A MATTER OF INTEREST: RECENT SARS RULING REGARDING INTEREST ON LATE PAYMENT OF BENEFITS

CONTINUED

Where a person receives a portion of their lump sum benefit late, there will no longer be a risk that the fund administrator will treat the amount as interest, which will be taxed as taxable income instead of being taxed as a withdrawal benefit or a retirement benefit.

and R660,000 are taxed at 18% whereas the portion of any retirement benefit up to R500,000, is not subject to any tax. On the other hand, any income that forms part of a person's taxable income is subject to higher rates. For example, for the 2018 year of assessment, if a person's taxable income is R500,000, she will pay R97,225 plus 36% on the difference between R500,000 and R410,460.

In terms of s10(1)(i) of the Act, R23,800 of the interest received from a South African source by a natural person under the age of 65, is exempt from income tax. If the person is older than 65, R34,500 of the interest received will be exempt. Any interest received during a year of assessment in excess of these amounts, is subject to income tax at the normal rates that apply to taxable income.

Ruling

BGR 31 states that interest on the late payment of benefits is any interest that is defined, as such, in terms of the rules of the fund. Any interest that increases a fund's benefit liability does not form a separate component from the benefit that is payable to the member and will be subject to tax under the provisions of the Second Schedule. Where an amount is transferred from one fund to another, the full amount (including fund growth) is considered to be a lump sum benefit and will be subject to the provisions of the Second Schedule. Interest that arises as a result of late payment of the benefit and therefore in addition to the benefit liability must be reflected separately and an IT3(b) certificate must be issued and submitted to SARS as per the prescribed processes.

Comment

The effect of BGR 31 is that where a person receives a portion of their lump sum benefit late, there will no longer be a risk that the fund administrator will treat the amount as interest, which will be taxed as taxable income instead of being taxed as a withdrawal benefit or a retirement benefit. This is to the benefit of individuals as any interest that a taxpayer receives due to late payment will be subject to a lower tax rate and BGR 31 should therefore be welcomed.

Louis Botha

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FOREIGN EMPLOYMENT INCOME, FOREIGN EMPLOYEES AND EMPLOYEES' TAX – SOME IMPORTANT CONSIDERATIONS

Issue Two of Interpretation Note 16 (IN 16) deals with the exemption of foreign employment income in terms of s10(1)(o) of the Income Tax Act.

In the 2017 Budget, the Minister of Finance announced that the exemption for foreign employment income that is currently provided for in terms of s10(1)(o) of the Income Tax Act, No 58 of 1962, would be reviewed and potentially amended. We reported on this in our Special Edition Budget Speech Tax and Exchange Control Alert on 22 February 2017. While there will be more clarity on this issue when the proposed draft legislation is released later this year, there are some other issues which employers and employees should also consider in setting up their employment operations.

In terms of s10(1)(o)(ii) of the Act, certain types of remuneration that a person receives or that accrues to a person for services rendered outside South Africa, will be exempt from income tax in South Africa ...

An interesting issue in this regard: the question of an employer's duty to withhold employees' tax, as discussed in Issue Two of Interpretation Note 16 (IN 16), which deals with the exemption of foreign employment income in terms of s10(1)(o) of the Income Tax Act. Furthermore, how much withholding tax should an employer withhold where a non-resident employee renders services in South Africa?

The legal principles

In terms of s10(1)(o)(ii) of the Act, certain types of remuneration that a person receives or that accrues to a person for services rendered outside South Africa, will be exempt from income tax in South Africa provided that the following two requirements are met:

- the person spent at least 183 days outside South Africa during any 12-month period; and
- during that 12 month period, the person spent at least 60 days continuously outside South Africa.

The Fourth Schedule to the Act (Fourth Schedule) defines remuneration broadly. It includes other types of remuneration not referred to in s10(1)(o)(ii). Paragraph 2 of the Fourth Schedule states that every employer who is a resident or representative employer (in the case of an employer who is not a resident) who pays or has to pay amounts that fall within the definition of "remuneration", must deduct and withhold employees' tax.

In terms of paragraph (ii) of the "gross income" definition in s1 of the Act, where a person is not a resident, only the amount received by or accrued to that person from a source within the Republic forms part of that person's gross income. If a person is not a South African for tax purposes and received remuneration from a South African company, one would have to look at where the services are rendered. Only to the extent that the services are rendered in South Africa, will the remuneration be received from a South African source. For example, if a non-resident employee receives remuneration from a South African resident employer and he spent 100 days of the year of assessment in South Africa in rendering the services, only that portion of his remuneration must be included in his gross income.

Deduction of employees' tax where remuneration is paid to non-resident employees

An interesting situation arises where a person is not a South African resident, but receives a salary from an employer who is a resident. When the principles referred to above are applied, it would appear that the employer would only have to withhold employees' tax to the extent that the

CLIFFE DEKKER HOFMEYR

FOREIGN EMPLOYMENT INCOME, FOREIGN EMPLOYEES AND EMPLOYEES' TAX – SOME IMPORTANT CONSIDERATIONS

CONTINUED

South African employers should therefore consider the provisions of the Act and the relevant DTA, before appointing foreign employees locally.

employee's remuneration originated from a South African source. As the s10(1)(o)(ii) exemption applies to any taxpayer and not only to South African residents, it would be possible for the non-resident employee to also rely on this provision, but the result would be the same and it would probably make more sense to determine the taxable portion with reference to where the services were rendered.

IN 16 states that where the s10(1)(o)(ii) exemption applies, an employer would still have the obligation to deduct employees' tax under the Fourth Schedule. If an employer elects not to deduct employees' tax and it turns out that the person did not qualify for the exemption, the employer would be liable for the employees' tax not deducted and any concomitant penalties and interest. It might be possible to argue that where a person is a non-resident and only a portion of their income is taxable in South Africa based on the source of the income, the same principles would apply.

It appears that the only way in which such a non-resident employee will be exempt from tax in South Africa, is where the double tax agreement (DTA) between South Africa and the country in which that person is a tax resident makes provision for this. For example, some DTAs concluded between South Africa and other countries state that where a non-resident employee receives remuneration for work done in South Africa, that remuneration will not be taxable in South Africa if the person:

- was outside of South Africa for more than 183 days;
- the remuneration was paid by or on behalf of an employer in the other state; and
- the remuneration is not borne by a permanent establishment or a fixed base which the employer has in South Africa.

Comment

South African employers who employ foreigners to do work in the country should take note of the above provisions. If a South African employer withholds employees' tax in excess of the amount that relates to income from a South African source, such a non-resident employee would have to most likely recoup the overpaid tax by lodging an objection against an assessment issued by SARS. The dispute resolution process can be very time-consuming and from a cash-flow perspective, could have a detrimental effect on such non-resident employees. South African employers should therefore consider the provisions of the Act and the relevant DTA, before appointing foreign employees locally.

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