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TAX & EXCHANGE CONTROL ALERT

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Proposed legislation for emigrants and retirement fund withdrawals

On 31 July 2020, National Treasury (Treasury) and the South African Revenue Service (SARS) published for public comment, the 2020 Draft Taxation Laws Amendment Bill (Draft TLAB). One key tax proposal entails an amendment to the definitions of the "*pension preservation fund*", "*provident preservation fund*" and "*retirement annuity fund*" concepts, as contemplated in section 1 of the Income Tax Act, 1962 (ITA) (collectively Retirement Fund). This proposal is informed by the government's intention to phase out the concept of "*emigration*", as recognised by the South African Reserve Bank (SARB) and introduce a new verification process that will apply to individuals emigrating from South Africa (SA).

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Background

Currently, as outlined in the 2020 Draft Explanatory Memorandum on the Draft TLAB, section 1 of the ITA makes provision for a payment of lump sum benefits when a member of a Retirement Fund withdraws from that fund due to their emigration from SA, provided that such emigration is recognised by the SARB, for exchange control purposes.

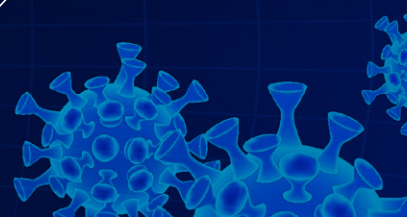
Since the government intends to phase out the concept of emigration (as it currently stands), certain provisions which regulate or make provision for circumstances relating to an individual's affairs upon their emigration from SA (as recognised by the SARB) would arguably become inoperative. This necessitates legislative intervention to close gaps in the law and to ensure an efficient application of the law.

The proposed test

In this instance, the Draft TLAB proposes that firstly, section 1 of the ITA be amended to remove the reference that a member is entitled to "payment of lump sum benefits when a member emigrates from SA and such emigration is recognised by the SARB for exchange control purposes"; and secondly, a new test should be applied which will make provision for the payment of lump sum benefits when a member ceases to be SA tax resident (as defined in the ITA). The proposed test essentially requires that a member should have remained non-tax resident for a period of at least three consecutive years and that member's non-tax residency should be determined in accordance with the ITA.

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Numerous other submissions were also made by individuals and companies operating in the retirement savings industry, indicating that the proposed amendment would have various unintended consequences.

Residency test

Under SA law, two tests are applicable to determine an individual's tax residency, namely the "ordinarily resident" test and the "physical presence test". An individual will be regarded as ordinarily resident if SA is the country to which they naturally return from their wanderings, which might be referred to as their usual or principal residence. If the first test is inapplicable, a person could be regarded as resident if they have been physically present in SA for period(s) exceeding –

1. 91 days in total during the year of assessment under consideration;
2. 91 days in total during each of the five years of assessment preceding the year of assessment under consideration; and
3. 915 days in total during those five preceding years of assessment.

On the other hand, an individual will cease to be SA tax resident if they are no longer ordinarily resident in SA or if they leave SA and remain physically outside of the country for a continuous period of at least 330 full days.

Public comments on the proposal

Members of the public had until 31 August 2020 to comment on the proposals set out in the Draft TLAB. From 9 to 11 September, workshops were hosted by Treasury during which the public had the opportunity to discuss the written submissions made and to make further oral submissions where relevant. Many of the submissions made, suggested that the proposed amendment was aimed at preventing persons from

withdrawing from a Retirement Fund and related to government's mooted intention regarding prescribed assets in which funds would have to invest. However, the representatives from Treasury made it clear that the reason for the proposed amendment was because the concept of emigration from a SARS perspective will no longer exist as a result of the Exchange Control Regulations, 1961 being replaced with a new capital flow management framework, as announced in the 2020 Budget (see our [2020 Special Budget Alert](#)). The three-year rule was intended to replace the emigration requirement that a person's emigration only becomes final once five years have passed since their emigration.

Numerous other submissions were also made by individuals and companies operating in the retirement savings industry, indicating that the proposed amendment would have various unintended consequences, such as –

- the financial burden on the Retirement Fund member as the amounts received from the funds are often used to cover settling-in costs in the new country of residence;
- the imposition of additional requirements to be met by Retirement Fund members and administrators, as well as SARS;
- a cash-flow delay on SARS' part while awaiting a lapse of the three-year period; and
- uncertainty as to the application of the residency tests and determination of the three-year period.

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It appears that the proposed amendment has several potential practical implications.

Draft Response Document

On 13 October 2020, Treasury and SARS published the draft responses to the public comments received on the 2020 draft bills, including the Draft TLAB (Response Document). Firstly, Treasury and SARS explained that the three-year rule is a mechanism to ensure that there is sufficient time lapse for the completion of all emigration processes, without affecting workers whose residence status changes for reasons other than emigration. In addition, the proposed system is intended to have much lower compliance burdens for individuals who choose to emigrate. Noting that when individuals contribute to pensions (tax-free), tax is deferred until benefits are received upon retirement, it was submitted that it was not the intention of the SA government to provide a tax incentive for funds to be used for emigration. The Response Document draws attention to the inequity between SA members who withdraw funds upon retirement (and continue to be resident in SA) and members who choose to emigrate, as those who leave SA are able to access funds within three years, while those members who do not leave SA are required to wait until retirement before they can access the funds. Therefore, the proposed provisions may well be regarded as a step to address this disparity and bridge the gap between members who remain SA tax resident and those who emigrate.

Secondly, as it was recommended that the ordinarily resident test be utilised as a measure to determine when residence ceases, Treasury and SARS refused that recommendation and clarified that the

three-year rule would apply if an individual ceased to be resident in SA, irrespective of the particular test used to make that determination.

Transitional Arrangements

Following the uncertainty around the impact of the proposed legislative changes on all applications received by the SARB before 1 March 2021, but which have not been finalised by that date, it was clarified that such applications would be finalised in accordance with the current process, provided that they are approved by the SARB even if the approval is granted after 1 March 2021. Therefore, the amended provision will apply to those emigration cases that meet the requirements on or after 1 March 2021, including those cases in respect of which formal approval was not granted.

Observation

It appears that the proposed amendment has several potential practical implications: Firstly, individuals who cease to be SA tax resident would no longer have immediate access to payment out of their Retirement Funds, as they would be required to comply with the three-year waiting period. Secondly, individuals would potentially have to be cautious of their 'wanderings' to avoid the inadvertent disruption of their tax residency or non-tax residency, as the case may be; and lastly, individuals might potentially be pressured to consider other savings and investment vehicles to avoid being subject to the three-year waiting period should they cease to be SA tax resident.

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Persons who do not hold savings in Retirement Funds, but who wish to cease their tax residency and emigrate from South Africa, are only affected in the sense that they cannot use the existing SARB emigration process to prove that they have emigrated and ceased their South African tax residency.

The proposed amendment raises the question as to whether the proposed test will apply unfairly and inefficiently, unlike the current test for emigration, as the latter requires a more deliberate action from the individual looking to emigrate (i.e. by formally applying to the SARB for approval and duly obtaining that approval).

An important issue to take into account, is that the proposed amendment adversely affects mainly South African tax residents ceasing their tax residence and

emigrating, who want to withdraw from their Retirement Funds. Persons who do not hold savings in Retirement Funds, but who wish to cease their tax residency and emigrate from South Africa, are only affected in the sense that they cannot use the existing SARB emigration process to prove that they have emigrated and ceased their South African tax residency. They would likely have to prove that they are no longer tax resident in South Africa, through other means.

Ursula Diale-Ali and Louis Botha

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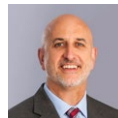
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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