EXPAT TAX: WILL IT CONTRIBUTE TO TAX EVASION BY SOUTH AFRICAN EXPATS WORKING ABROAD?

by

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ABSTRACT

South African expats who work abroad used to enjoy a full exemption of tax on their foreign remuneration income, but the National Treasury and SARS had ‘expat tax’ up their sleeves. Pravin Gordhan, the previous Minister of Finance, made their intention to review the exemption known during the 2017 Annual Budget Speech held on 22 February 2017 (National Treasury, 2017a; Pretorius, 2017). This amendment was however only promulgated on the 22nd of October 2020 and held that only R1.25 million of employment income earned abroad by a South African resident will be exempt from tax per annum, subject to certain requirements, as from the 1st of March 2020 (SARS, 2020a). This amendment limited the previous 100% exemption contained in section 10(1)(o)(ii) of the Income Tax Act No. 58 of 1962 and resulted in ‘expat tax’.

Expats would undoubtedly weigh their options in counteracting the imposed expat tax, which might further increase the already worrisome tax gap in South Africa (Business Tech, 2019a; Smith, 2019). The study answered its research question of whether expat tax will contribute to tax evasion by South Africans working abroad by reaching set research objectives, as mentioned in Section 1.5, by way of a systematised review. The study found that the two most influential tax evasion factors present in South Africa, namely the perceptions of government and high tax rates as identified in a previous study conducted by the researcher (Ferreira, 2017), were also present in the reactions or expected reactions, of expats to expat tax.

Expat tax may be new to South Africa but tax evasion certainly is not. Should the expected evasion of the newly implemented expat tax in South Africa materialise, the tax gap would be placed under further strain.

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ACRONYMS LIST

BEE	Black Economic Empowerment
CFC	Controlled Foreign Company
CGT	Capital Gains Tax
DTA	Double Taxation Agreement
EY	Ernst and Young
FAQ	Frequently Asked Questions
GAAR	General Anti-Avoidance Rules
MTC	Model Tax Convention
OECD	Organisation for Economic Cooperation and Development
PAYE	Pay-As-You-Earn
PWC	PricewaterhouseCoopers
SAICA	South African Institute of Chartered Accountants
SAIT	South African Institute of Tax Practitioners
SARB	South African Reserve Bank
SARS	South African Revenue Service
TAA	Tax Administration Act No. 28 of 2011
TLAB	Tax Laws Amendment Bill
UAE	United Arab Emirates

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CHAPTER ONE: INTRODUCTION

1.1 INTRODUCTION

If you drive a car, I'll tax the street

If you try to sit, I'll tax your seat

If you get too cold, I'll tax the heat

If you take a walk, I'll tax your feet

'Cause I'm the taxman, yeah, I'm the taxman…

(*Taxman* lyrics, The Beatles)

The Beatle's lead guitarist George Harrison expressed his frustration of being heavily taxed on his new-found wealth by writing *Taxman* in 1966 (Rybaczewski, 2020). Although years have passed since Harrison lamented his situation, many South Africans share this sentiment today.

Taxes come for those that are rich or poor; alive or dead. They have become inescapable, even to those that no longer work in South Africa. Expatriates (expats) who remained tax residents in South Africa used to enjoy a full exemption of taxes on their foreign remuneration income. Section 10(1)(o)(ii) of the Income Tax Act No. 58 of 1962 (hereafter the Act) provided that any South African resident who received remuneration income by rendering services abroad under an employment contract would be 100% exempt. However, Pravin Gordhan, the previous Minister of Finance, threw a spanner in the works during the 2017 Annual Budget Speech. On 22 February 2017, he revealed the government's intention to review this exemption on foreign employment income (National Treasury, 2017a; Pretorius, 2017). Concerned stakeholders hastily submitted a formal document to the National Treasury on 17 May 2017 in response to the proposed amendment; these stakeholders included the likes of SAICA (South African Institute of Chartered Accountants), SAIT (South African Institute of Tax Practitioners), Deloitte, Ernst and Young (EY), KPMG, PWC (PricewaterhouseCoopers) and many others (SAICA, 2017). Others also formed a petition group on Facebook, namely the South African Tax Petition Group, to counter the proposed amendment (Expatriate Tax Petition Group, 2020; Seafarers Global, 2020). Van Zyl (2020) stated that this was the biggest public response ever recorded in South Africa – indicating a possible tax revolt.

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In the Draft Taxation Laws Amendment Bill (TLAB) released by Parliament on 19 July 2017, the exemption was repealed in full effect as from 1 March 2019 (Draft TLAB, 2017; Mzizi, 2017; PWC, 2017). This came as a further shock. Once public comments were allowed, the petition group and various other parties also submitted formal commentary to National Treasury and SARS (South African Revenue Service) in protest, voicing their concerns about the severe financial impact expected and the abruptness of the amendment (Expatriate Tax Petition Group, 2020; Seafarers Global, 2020). These views were taken into account by Parliament and resulted in the postponement of the effective date to 1 March 2020 and the implementation of the exemption threshold of R1 million per annum (Expatriate Tax Petition Group, 2020; National Treasury, 2017b). The effective date of the amendment was postponed, enabling natural persons to adjust their tax affairs and to formalise their tax status – giving expats extended time to rearrange their tax affairs and potentially side-step the newly imposed tax.

This amendment gave rise to 'expat tax'. SARS, however, argues that the amendment does not give rise to a 'new' tax. South African residents are taxed on their worldwide income in South Africa (paragraph (i) of the definition of "gross income" in Section 1 of the Act). Expatriates who earn remuneration income abroad qualify for the section 10(1)(o)(ii) exemption if they meet all the prescribed requirements, resulting in such remuneration income not being taxed in South Africa. However, these residents are taxed on their foreign remuneration income if the requirements are not met. SARS views the amendment as a limitation of the section 10(1)(o)(ii) exemption that was already in place; a mere rate change and not a policy change (SARS Frequently Asked Questions [FAQ], 2020). The amendment is, however, viewed as the introduction of a newly imposed tax, namely expat tax, by South African expats working abroad. This study will refer to it as such.

SARS finalised the process by publishing Interpretation Note 16 (Issue 3) on 31 January 2020, which dictates the interpretation of the foreign employment income exemption (SARS Interpretation Note 16, 2020). The Minister of Finance (Tito Mboweni) increased the exemption to R1.25 million per annum in his Budget Speech delivered on 26 February 2020 (National Treasury, 2020a). The revised section 10(1)(o)(ii) of the Act still held the same requirements as its predecessor, save that resident expatriates would now be taxed on their foreign remuneration income in excess of R1.25 million per annum (SARS, 2020a).

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It is important to note that the exemption effectively only applies to South African residents. A resident is defined in Section 1 of the Act as an individual who meets the requirements of either the ordinarily resident or physical presence test. Being ordinarily resident implies that an individual regards South Africa as their real home and the place where they would return to from their travels (CIR v Kuttel, 1992:19; Cohen v CIR, 1946:371). This implies that expatriates who work abroad could still be regarded as South African tax residents and hence be taxed in South Africa on a worldwide basis (paragraph (i) of the definition of “gross income” in Section 1 of the Act) – making tax residency a hurdle in shaking the newly imposed expat tax. Non-residents are only taxable in South Africa on their South African source income (paragraph (ii) of the definition of “gross income” in Section 1 of the Act). As income derived from a foreign source is not taxable in South Africa (CIR v Lever Bros. and Unilever Ltd, 1946:23), the need for the exemption is dismissed. South African residency may also be broken by being deemed exclusively a resident of another country by way of a tie-breaker clause in a double taxation agreement (DTA) (Article 4(2) of the DTA between South Africa and the United Arab Emirates [UAE]; Article 4(2) of the Organisation for Economic Cooperation and Development [OECD] Model Tax Convention [MTC]). DTA’s will briefly be discussed later in the study.

> *…‘Cause I'm the taxman, yeah, I'm the taxman*
>
> *And you're working for no one but me…*
>
> (*Taxman* lyrics, The Beatles)

The term “expat”, short for an expatriate, is derived from the Latin words *ex* (out of) and *patria* (fatherland), which refers to individuals living in countries other than their country of citizenship, usually temporarily or for work purposes (Dictionary.com, 2020a; Kagan, 2018). These individuals will now be taxed in South Africa on their foreign remuneration income exceeding the R1.25 million threshold per annum, as from 1 March 2020 (National Treasury, 2020a; SARS, 2020a). This newly imposed expat tax distressed many South Africans (Brothwell, 2020).

However, there are options to avoid the tax altogether. These include ending expatriate work and returning to South Africa or attempting to cease South African tax residency, which may or may not include formal emigration (Hogg, 2019a; Leon, 2018). Many taxpayers are most likely to adopt an “ostrich – head in the sand” or a “catch me if you

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can" approach (Leon, 2018). These approaches may vary between avoiding expat tax, aggressive tax planning and outright evasion of the imposed expat tax. Tax avoidance is already a significant problem in South Africa. However, the fact that income tax returns, until very recently, did not ask detailed questions pertaining to residency might have added to the likelihood of tax avoidance by expats (Van Zyl, 2020).

Tax avoidance is the legal utilisation of loopholes in legislation to reduce tax liabilities whereas **tax evasion** is illegal (Dare, Du Plessis and Jansen, 2019). Every individual has the right to arrange their affairs legally in an effort to reduce their tax burden (Prebble and Prebble, 2010; IRC v Duke of Westminster, 1936) however tax evasion crosses the line. **Aggressive tax planning** is the grey area wherein the use of loopholes is morally questionable (Payne and Raiborn, 2018) and leans toward evasion (Joffe, 2020).

South Africa is no stranger to tax evasion - the tax gap is estimated to be more than R100 billion for the 2020 tax year (Joffe, 2020). Judge Dennis Davis estimated that R50 million of the R100 million tax gap is caused by tax fraud and tax evasion, most of which is due to non-payment of tax by high-income earning individuals (Ensor, 2019). A country's tax gap is defined as the gap between the amount of tax that ought to be paid and what is paid in reality. SARS commissioner, Edward Kieswetter, confirms South Africa's tax gap predicament by stating that tax revenue collection is under threat and that the government may soon be starved of resources. He also argues that the main cause for this is failing trust in SARS, giving rise to tax avoidance and fraud (Smith, 2019). Kieswetter states that the Covid-19 pandemic will lead to a decrease in tax revenue collection, further increasing the tax gap (De Lange, 2020). Tax measures announced by the National Treasury in response to Covid-19 will cost an estimated R15 billion in government revenue (Joffe, 2020).

South Africa has an exceptionally small tax base, where three (3) million high-income earning individuals within a population of 56 million carried 97% of the personal income tax burden for 2019 (Kruger, 2020; SARS, 2020b). As tax evasion is a common occurrence, it is unlikely that South Africa's tax revenue collection will increase and the tax gap will decrease any time soon. The government heavily relies on these high-income earning individuals to carry a heavy tax load and losing even one to emigration might topple the government's fruit cart (Davis, 2019; Smith, 2019).

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Since the announcement of the expat tax, South Africa has already experienced a sharp increase in citizens emigrating to end their tax residency and escape this expat tax (Bloomberg, 2020; Goncalves, 2020; Business Tech, 2019c). This is also evident in the Government's desperate attempt to retain expats as tax residents by increasing the initial R1 million exemption cap to R1.25 million (Leon and Du Toit, 2020). Financial emigration generally entails both formal emigration and tax emigration, where formal emigration entails the process of formally exiting South Africa for exchange control purposes (LCR Capital Partners, 2019) and tax emigration involves the termination of tax residency with SARS (Tax Consulting, 2020). Angel Jones of Homecoming Revolution believes that more than 2.7 million of these treasured South Africans were living and working abroad in 2019 (Business Tech, 2019d; My Broadband, 2019). Expats living and working abroad fall within the expat tax scope and will duly react on the imposed legislation, which may or may not entail emigration.

Formal emigration will, however, be phased out by 1 March 2021 in accordance with the Africa Free Trade Agreement entered into by South Africa and 54 other countries (National Treasury, 2020a; The South African Tax Company, 2020; Visser, 2020). National Treasury seemingly dropped another bombshell in the Draft TLAB, issued on 31 July 2020, seeking to prevent tax non-residents from accessing or withdrawing their South African retirement funds for three years after their formal emigration from South Africa (Talk of the Town, 2020). If promulgated, this change will likely come into effect on 1 March 2021. These announcements leave expatriates with only a few months until March 2021 to whip up a game plan.

This brings into question the possibility of a tax revolt. A tax revolt refers to an act of rebellion by citizens of a country, resulting in tax manipulation and openly refusing to pay taxes (The Conversation, 2019). Dissatisfaction with the government and unfair tax regimes tend to spark tax revolts (Ramfol, 2019a). Financial or formal emigration to cease South African tax residency is regarded as a form of tax revolt, with a good possibility of sky-rocketing in reaction to the expat tax (Business Tech, 2019c; Schneider, 2019). Additionally, financial emigration results in a 'brain drain', where skilled professionals leave the country in numbers (Business Tech, 2018a).

If South Africans resort to ceasing tax residency, SARS and the South African government will have a reason for concern. The newly imposed expat tax might finally push taxpayers

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in the direction of aggressive tax avoidance, which may or may not cross the line into evasion (Smith, 2019).

1.2 PROBLEM STATEMENT

Tax evasion is a crime which is not taken lightly, as millions of rands are annually lost to tax criminals (Ensor, 2019; Venter, 2012). The most significant indicator of the presence of tax evasion is the 'tax gap' that exists in a country (Dare, Du Plessis and Jansen, 2019; Andreoni, Erard and Feinstein, 1998). As stated, the so-called 'tax gap' refers to the difference between the expected tax revenue that is theoretically collectable and the amount being collected by SARS. Apart from tax evasion, a tax gap also indicates non-compliance and criminal activities (Joffe, 2020; Oberholzer and Stack, 2009). SARS recorded a R66.3 billion shortfall in government revenue for the 2019 tax year (Joffe, 2020). This shortfall implies that government income is not nearly enough to cover its operational expenses (Kenton, 2019). The current tax gap highlights the immense effect of tax evasion in South Africa.

Expats will, in response to the implementation of expat tax, take certain steps to organise their affairs in order to sidestep the tax (Business Tech, 2019a; Smith, 2019). These steps may further increase the tax gap as the expat tax that SARS was expecting to collect from these expats will no longer be collected or be greatly reduced (Business Tech, 2019a; Smith, 2019). These steps may involve aggressive tax planning as is evident from many expatriates having already left the country (My Broadband, 2019). As aggressive tax planning may border on tax evasion (Joffe, 2020), the question arises as to whether these steps implemented by expatriates in curbing expat tax, will, in fact, cross the line into tax evasion and further increase the already worrisome tax gap in South Africa.

Expat tax came into effect from 1 March 2020 and will only be assessed for the first time as part of the 2021 year of assessment, ending on 28 February 2021. It is, therefore, a new concept to South Africa and no studies have been conducted on the topic yet – especially not its possible link to tax evasion. A knowledge gap therefore exists. This is evident from the lack of academic articles on expat tax pertaining to South Africans working abroad. Studies on tax evasion in general and tax evasion in South Africa are in abundance but with no formal link made to tax evasion. Many web articles exist that

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mention this link and the effects thereof but no formal study has been conducted on this topic.

1.3 PURPOSE OF THE STUDY

SARS serves as the revenue collector for the South African government. If South Africans yield to the alluring perks of tax evasion, SARS will have less tax revenue to deliver to the government and this in effect will starve the country of resources (Smith, 2019).

This study therefore aims to determine whether the implementation of expat tax in South Africa will contribute to or increase tax evasion in the country. Tax evasion is perceived as a decision made based on various factors (Cummings *et al.*, 2009:456). There are many factors identified globally that cause tax evasion (Cummings *et al.,* 2009). The study will focus on the main factors leading to tax evasion in South Africa and will determine whether these factors will be present in the responses of South African expatriates to the introduction of expat tax. Determining this will better equip SARS to enforce the new expat tax and confront tax evasion in order to narrow the tax gap.

Not a penny can be lost in the fight against tax evasion in South Africa - the 'golden goose' is under further threat. SARS and the government need to regain the loyalty of South Africans and intensify the onslaught against tax evasion.

1.4 RESEARCH QUESTION

The research question guiding this study is whether the newly imposed expat tax will contribute to tax evasion by South Africans working abroad.

1.5 RESEARCH OBJECTIVES

The following research objectives will be pursued to find an answer to the research question:

- To understand the extent of the 'new' expat tax. This includes a general overview of the definition of (tax) resident as well as an allocation of taxing rights for remuneration income in a DTA context, including the tie-breaker clause in the case of dual residency. To get a general overview of section 10(1)(o)(ii) before and after the amendment and a general overview of the double tax relief provided for by the

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section 6*quat*(1) rebate. The section 6*quat*(1) rebate is of course not available when remuneration income is earned by an expat in a tax-free country (for example the UAE). Exit tax, with emphasis on capital gains tax (CGT) arising upon ceasing tax residency is also briefly explained.

- To identify the options available to affected South African expats in response to the imposed expat tax.
- To define tax avoidance and tax evasion.
- To identify the various factors causing tax evasion.
- To understand the extent of tax evasion in South Africa.
- To compare the factors giving rise to the various options available to affected South African expats in response to the amendment to the factors causing tax evasion.
- To conclude whether these available options can be regarded as evasion and therefore contribute to tax evasion in South Africa.

1.6 SCOPE OF THE STUDY

Limitation of the scope aims to keep the study focused on the set research question and objectives. The focus of the study is on "South African expats working abroad" (as referred to in the title). The following taxpayers are included in this term and therefore fall within the scope of this study:

- Individuals earning foreign remuneration income: The study, therefore, excludes self-employed individuals and independent contractors as they are specifically excluded from the section 10(1)(o)(ii) exemption and could therefore not make use of the exemption in the past before expat tax was introduced. Other individuals excluded from the exemption are public officers and those employed by the government. The study will focus on remuneration from private industry employers in the form of cash salaries, allowances and fringe benefits only. It will also not include remuneration from retirement funds such as pensions.

- Working for a foreign employer abroad: The study will exclude self-employed individuals and individuals working abroad for South African employers or their associate institutions. Employment aboard a ship or aircraft will also be excluded.

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- Being tax residents of South Africa: The study will focus on individuals who either were still ordinarily resident in South Africa or who met the physical presence test before the introduction of the expat tax.

- The exemption of foreign remuneration income under section 10(1)(o)(ii) of the Act: The study will briefly discuss section 10(1)(o)(ii) to understand its extent but will not focus on the exemption itself. The focus will rather be on the resident definition and the responses of individuals who fall outside the South African tax net. In this way, the exemption is no longer needed. DTA's and the tie-breaker clause for dual residency will also briefly be discussed as it forms part of determining an individual's tax residency. South Africa's DTA with the UAE will be used as proxy DTA in this study. This DTA was selected as the UAE levies no income tax and any expat working in the UAE will therefore be very well aware of the impact of the introduction of expat tax. Furthermore, it is estimated that nearly 100,000 South African expatriates reside in Dubai alone (Ryan, 2020).

- Although not relevant in the case of employment income earned in the UAE, the section 6*quat*(1) rebate for foreign taxes paid will be discussed briefly but not the section 6*quat*(1C) and (1D) deduction, as these pertain to South African sourced income earned by residents.

- The study will also only mention the CGT implication on the cessation of tax residency (exit tax) but will also not discuss it in detail.

Regarding 'tax evasion', the following are included in the scope of this study:

- Factors leading to tax evasion: Only those factors identified in previous research studies and which are relevant to South Africa will be included in the study.

- The extent of tax evasion in South Africa: The study will only focus on the extent of tax evasion in South Africa and no other country.

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1.7 ASSUMPTIONS

For purposes of this study, the assumption was made that the exemption in terms of section 10(1)(o)(ii) of the Act is limited to R1.25 million per annum. This is supported by the announcement made by the Finance Minister in his Budget Speech delivered on 26 February 2020 (National Treasury, 2020a). SARS Interpretation Note 16 (Issue 3) has not been updated with the increased R1.25 million exemption to date (30 April 2020) and still refers to R1 million. SARS' website (2020a) and the SARS FAQ (2020), however, already refer to the R1.25 million limitation.

1.8 RESEARCH DESIGN AND METHODOLOGY

Goddard and Melville (2004:12) refer to research being a recipe where identifying a problem topic, formulating a research question and conducting research to answer the research question are the key 'ingredients'. The study adapted this view by following a concise research design and methodology.

Research design entails the strategy with which the study will be conducted. This strategy aims to meet the research objectives by integrating various components of the study and relaying information gathered logically and comprehensively (De Vaus, 2001). The various design elements used to gather information relevant to the study will now briefly be discussed.

Pragmatism

Pragmatism is a philosophical approach where theories are assessed based on their practicality in solving problems (Sekaran and Bougie, 2016; Morgan, 2014:1046). A pragmatic study is perceived as provisional; changing as time moves on (Patton, 2015). The study aims to analyse research already conducted and to draw conclusions from its findings and to reflect a pragmatic philosophical stance.

Nature of the study

A descriptive study focuses on describing the various characteristics of existing topics, issues and events (Datt and Chetty, 2016). This type of research seeks to find patterns and identify areas for future research (Duloch, 1993:154). This study will be descriptive as it will describe the various characteristics of expat tax and tax evasion individually. Tax

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evasion patterns will be identified to predict whether expat tax will be just another casualty of evasion in South Africa.

Method of reasoning

Inductive reasoning refers to a reasoning process based on observation. Patterns or repetitions are usually observed (Zalaghi & Khazaei, 2016:24). A phenomenon will be observed to formulate a theory (Patton, 2015). Existing literature will be analysed to establish the recurring patterns of tax evasion. The phenomenon of tax evasion will be applied to generating a research theory.

Time horizon

Data will be gathered on a perceived phenomenon at a specific point in time and analysed to form a conclusion, implying a cross-sectional study (Booth *et al.*, 2016; Sekaran and Bougie, 2016; Levin, 2014:24). Data on expat tax will be gathered at the time of its announcement and implementation (2017 to 2020) and data on tax evasion in South Africa during the past decade (2010 to 2020) will also be used.

Unit of analysis

The study's research question will guide the unit of analysis in determining on what or who and in how much detail data needs to be collected to form a research conclusion (Sekaran and Bougie, 2016). The study's unit of analysis is academic literature relating to expat tax and tax evasion but also the reaction of expatriates to expat tax.

Nature of the data

The nature of data collected depends on the source it is collected from as well as the type of data. Secondary data refers to data that is collected from previously conducted studies and existing sources (Patton, 2015; Johnston, 2014:619). Qualitative data is not numerical but is rather collected from literature (Bacon-Shone, 2016:13). The study will use secondary data in the form of academic articles, news reports, web articles and tax legislation to represent the findings qualitatively.

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Systemised review

A systematic review refers to a study where a focused question is guided by a set of objectives. These objectives are in turn formulated by analysing the data and evidence collected (Hastak, Khallaf & Naderpajouh. 2017:1-10). The study aims to answer the research question of whether expat tax will contribute to tax evasion by South Africans working abroad by reaching set research objectives, as mentioned in Section 1.5, by way of a systematised review.

1.9 BREAK DOWN OF THE STUDY

The study will be broken down into five chapters. The first chapter is the introduction to introduce the research topic. This chapter sets out the problem areas relating to the topic, explains the knowledge gap and states the research objectives and the research question. How the study will be conducted is also discussed.

Chapter Two will discuss expat tax and tax evasion to analyse the link between these concepts. The possible responses of South African expats working abroad to the announcement of the expat tax will be identified, as these expatriates had an extended period to react to the tax since the announcement of the government's intention to review the exemption (22 February 2017) and its enforcement on 1 March 2020. Factors that are known to cause tax evasion and which are relevant to South Africa will be discussed.

Chapter Three will attempt to determine whether the identified responses of expats to expat tax will contribute to tax evasion in South Africa, with specific reference to the tax evasion factors currently present in South Africa. This chapter aims to answer the research question. The final chapter, Chapter Four, sets out the conclusion by answering the research question and providing recommendations for future research.

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CHAPTER TWO: EXPAT TAX AND TAX EVASION

2.1 EXPAT TAX

2.1.1 Introduction

More and more South African citizens are working abroad in this modern age due to a myriad of reasons. It is reported that over 2.7 million South Africans are living abroad (My Broadband, 2019) and that roughly 100,000 South Africans reside in Dubai alone (Ryan, 2020).

Expat tax is a new concept to South Africans as it only became effective on 1 March 2020. Up until 29 February 2020, foreign remuneration income earned by South African tax residents was fully exempt under section 10(1)(o)(ii) of the Act. The government however already stated its intention to review the exemption during the 2017 Budget Speech, held on 22 February 2017 (National Treasury, 2017a; Pretorius, 2017). This was not welcomed by various stakeholders who submitted formal documents to the National Treasury to counter the proposed amendment shortly thereafter (Seafarers Global, 2020; Expatriate Tax Petition Group, 2020; SAICA, 2017). Parliament considered the submitted concerns by implementing a R1 million annual exemption threshold and postponing the effective date of the proposed amendment to 1 March 2020 (Expatriate Tax Petition Group; National Treasury, 2017b). This small victory provided South African expatriates extended time within which to get their tax affairs in order or implement aggressive tax planning.

The previous exemption aimed to avoid double taxation but instead resulted in double non-taxation (SARS, 2020a). Double taxation is the product of being taxed in South Africa and another country on the same remuneration received, whereas double non-taxation implies not being taxed in either country (SARS Interpretation Note 16:1). A good example of this is a South African tax resident working in the Middle East (such as the UAE) who would have enjoyed paying neither income tax on the foreign remuneration income in South Africa due to the exemption nor in the other country as it does not levy any income tax (Currency Partners, 2020). As double non-taxation was contrary to the initial intention of the exemption, SARS limited the exemption to R1m and then later to R1.25m (SARS, 2020a). As of 1 March 2020, income tax is payable on foreign remuneration income above this threshold of R1.25m and this marks the introduction of expat tax in South Africa.

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Many South Africans working abroad are unsure of the extent and effect of expat tax, as well as of the various options available to them in reaction to the amended legislation. This will be discussed in detail next.

2.1.2 Legislation

The legislation that effectively gives rise to expat tax is contained in section 10(1)(o)(ii) of the Act. Section 10(1)(o)(ii) provides for an exemption of foreign remuneration income included in gross income and which was earned by South African tax residents for services physically rendered abroad.

For the exemption to apply, the resident has to spend more than 183 full days (of which more than 60 days have to be continuous) in any 12-month period starting or ending in the relevant tax year, outside South Africa. This requirement will not be discussed in detail for this study. This exemption is however limited to R1.25 million per annum, meaning that any amount received in excess of R1.25 million will be included in taxable income and subject to income tax in South Africa, irrespective of whether any income tax was levied in the country of source.

The DTA usually gives taxing rights to both the resident state (South Africa for purposes of this study) and the source state (the country where the services are physically being rendered) (Article 14(1) of the DTA between South Africa and the UAE; Article 14 of the OECD MTC). However, in some instances, the source state may lose taxing rights. Even if a source country has taxing rights, income tax may not be levied according to its domestic laws, as in the case of the UAE.

Should the excess foreign remuneration income above R1.25 million be taxed in South Africa as well as in the source country of employment, double taxation will exist. Relief from double tax can be obtained under either the relevant DTA (Article 22(1) of the DTA between South Africa and the UAE; Article 23 of the OECD MTC of 2017) or under the domestic law of the resident state. South Africa provides relief to residents from double taxation on any foreign-sourced income, by way of a tax credit under section 6*quat*(1) of the Act.

For an individual to qualify for the R1.25m exemption, certain requirements need to be met (SARS Interpretation Note 16 [issue 3]:2-8). A taxpayer must:

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- be a South African tax resident,
- earn specific types of remuneration,
- by way of employment for services rendered,
- physically outside South Africa,
- for the qualifying amount of days during any 12 month period, and
- not fall under the specific exclusions to the exemption.

Before discussing the exemption in detail, it must be understood when an individual will be considered a South African tax resident. Tax residents are taxed on a worldwide basis, whereas non-residents are taxed on a source basis.

2.1.2.1 South African tax resident

The definition of a "resident" as referred to in paragraph (a)(i) and (ii) of Section 1 of the Act, states that there are two tests in determining whether an individual qualifies as a South African tax resident, namely the ordinarily resident test and the physical presence test. These two tests are mutually exclusive. The ordinarily resident test takes preference in this regard. Once it is established that an individual is not ordinarily resident in South Africa, only then may the physical presence test be applied.

2.1.2.1.1 Ordinarily resident test

This is the first test in determining whether an individual is a South African resident. If this test applies, the physical presence test would not be applicable. Therefore, the physical presence test cannot be applied in a year of assessment during which the person was at any time ordinarily resident in South Africa. Section 1 of the Act does not define the term, "ordinarily resident", therefore case law needs to be considered.

A person is ordinarily resident if they deem South Africa their real home and the place they would normally return to from their travels or where his permanent place of abode is (CIR v Kuttel, 1992:19; Cohen v CIR, 1946:371). The term "ordinarily resident" is more refined than "resident". A person is ordinarily resident where he normally resides, apart from temporary or occasional absences. It follows that a person cannot be ordinarily resident in more than one country at a time (CIR v Kuttel, 1992:19). Being "ordinarily resident" does

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therefore not necessarily mean being physically present. A natural person who had not been physically present in South Africa at all during the entire year of assessment could still be "ordinarily resident" in South Africa (Cohen v CIR, 1946:371; SARS Interpretation Note 3 [issue 2]:2,5).

SARS issued Interpretation Note 3 as a guide in determining whether a person is ordinarily resident. It is a question of fact and the burden of proof is on the individual (section 102 of the Tax Administration Act 28 of 2011 [TAA]). Each case needs to be decided on its facts and circumstances. A person who is ordinarily resident in South Africa in a specific tax year, will not be a resident for South African tax purposes if that person is exclusively deemed a resident of another country under the relevant DTA (definition of a "resident" as per section 1 of the Act).

Attempting to cease being a tax resident of South Africa is the most difficult type of residency to break. In Interpretation Note 3, the following two requirements are listed as necessary to prove that a person is not ordinarily resident in South Africa anymore:

- An intention to become ordinarily resident in another country; *and*
- Steps indicative of this intention having been or being carried out.

In considering the above two requirements, the court will consider the following objective factors:

- Most fixed and settled place of residence;
- Habitual abode (present habits and mode of life);
- Place of business and personal interest;
- Status of the individual in country (such as immigrant, work permit periods and conditions);
- Location of personal belongings;
- Nationality;
- Family and social relations (such as school and church);
- Political, cultural or other activities;
- Application for permanent residence;
- Period abroad, purpose and nature of visits; and
- Frequency of and reasons for visits.

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This list is not complete. When a person states that they are no longer ordinarily resident in South Africa, the relevant objective facts and actions taken by them must support their statement. It is important to note that formal emigration from South Africa would merely form part of the objective factors to be considered in determining whether a person no longer intends to ordinarily reside in South Africa. The presence or absence of formal emigration is not definitive in any way (Van Zyl, 2019).

To become ordinarily resident in another country, a clean or distinct break with South Africa is necessary. If the person is still regularly visiting or maintaining links with South Africa, it may be difficult to prove to SARS that the ordinarily residence in South Africa was indeed broken. Maintaining links could be, for example, a South African beach holiday house or membership of a country club (Van Zyl, 2019).

A natural person who ceases to be ordinarily resident in South Africa will cease to be a 'resident' from the day they subjectively consider *themselves* as such. This date may fall in the middle of a year of assessment, meaning that for a part of the tax year the person will be taxed as a resident on a worldwide basis and for a part as a non-resident on a source basis. There may also be income tax consequences (so-called exit tax) upon ceasing to be a resident. The physical presence test cannot be applied in a year of assessment during which the person was at any time ordinarily resident in South Africa. In subsequent years, however, the physical presence test may be applied (SARS Interpretation Note 3 [issue 2]:3,7).

2.1.2.1.2 Physical presence test

According to the definition of a "resident" as per paragraph (a)(ii) of section 1 of the Act, an individual who is not ordinarily resident in South Africa during a specific tax year will still be regarded as a tax resident if they are physically present in the country for the following number of days:

- exceeding 91 days in aggregate during the current year of assessment;
- exceeding 91 days in aggregate during each of the previous five years preceding the current year of assessment; and
- exceeding 915 days in aggregate during the preceding five years of assessment.

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These periods need not be continuous. In counting the number of days, part of a day counts as a full day but days in transit are not counted (Proviso (A) to paragraph (a)(ii) of the definition in the Act). Once an individual fulfils these three requirements, they will be regarded as a South African tax resident from the first day (1 March) of the sixth year of assessment. This test needs to be done annually to establish whether a person meets all three requirements (SARS Interpretation Note 4 [issue 5]:2).

Should all three criteria not be met in the following tax year, the person will not be a South African tax resident in the following tax year and will cease to be South African tax residency on the last day of the current tax year. Ceasing to be a resident under the physical presence test may also result in an exit tax. The person will once again be a resident as from the first day of a subsequent tax year in which all three requirements for the physical presence test are met. It follows that residency can be avoided by either ensuring that:

- a person never physically spends more than 91 days in South Africa in any year of assessment; or
- ensuring that the person physically spends 91 days or less in South Africa every sixth year of assessment.

In one specific instance, tax residency under the physical presence test can cease in the middle of a tax year and not on the last day of a previous tax year. This will be the case where the individual remains physically outside of South Africa for a continuous period of at least 330 full days after the day on which they left South Africa. This means for a part of the tax year the person will be taxed as a resident on a worldwide basis and for a part as a non-resident on a source basis. The continuous period of at least 330 full days will always extend over two years of assessment. It is further important to note that the 330-day rule can only be applied where the natural person was a resident under the physical presence test and not under the ordinarily resident test (SARS Interpretation Note 4 [issue 5]:6-7).

The onus of proving how many days were spent in South Africa is on the taxpayer by providing, for example, passport stamps upon entering and leaving a country (Section 102 and 29 of the TAA). A person who meets the physical presence test in a specific tax year will again not be a resident for South African tax purposes if that person is exclusively deemed a resident of another country under the relevant DTA (definition of a “resident” as

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per section 1 of the Act). The figure below perfectly sets out the steps in determining whether an individual qualifies as a South African resident per the physical presence test:

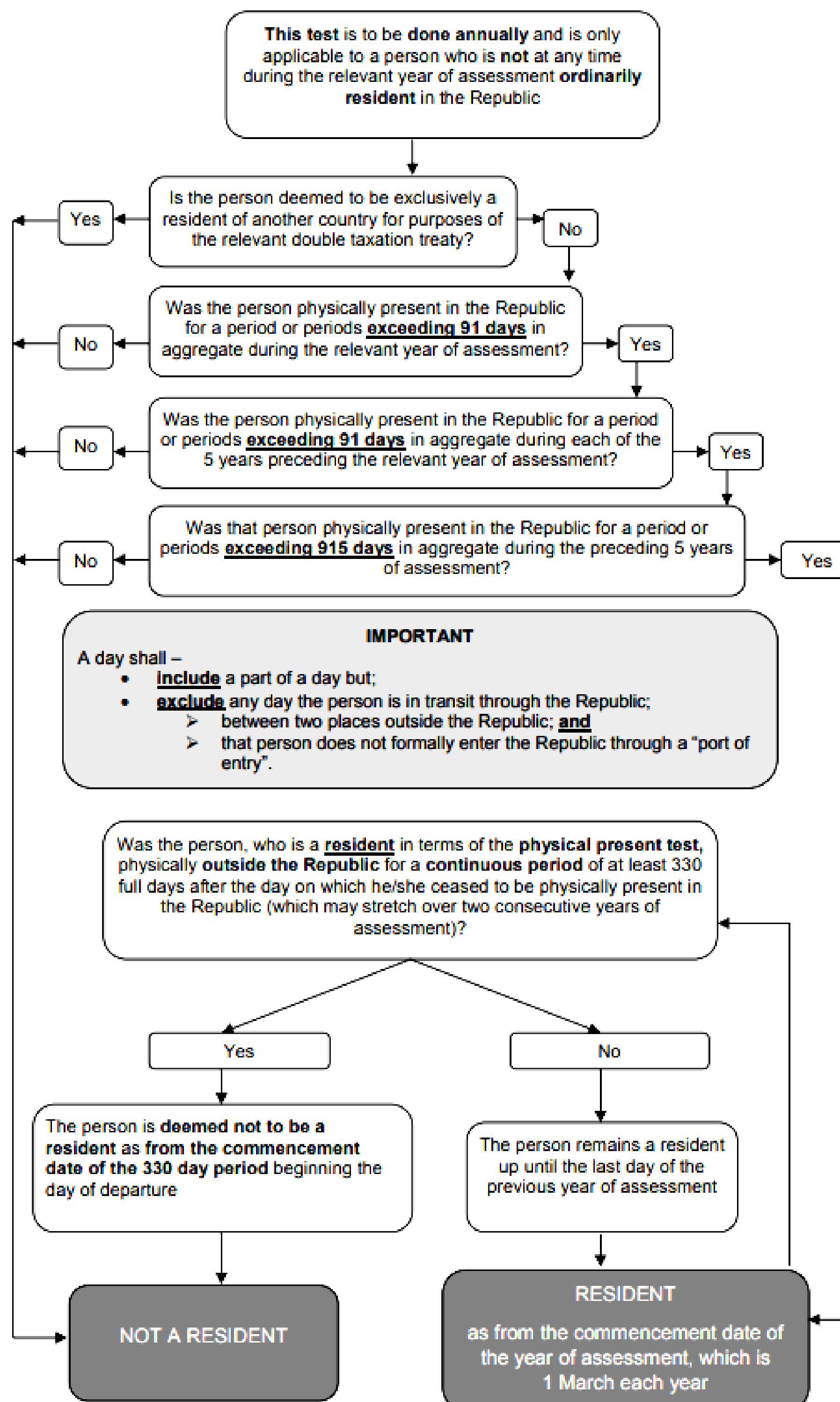

Figure 1: Physical presence test

Source: SARS Interpretation Note 4 (issue 5):10

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If a person is deemed to be exclusively a tax resident of another country under a relevant DTA (tax treaty), that person cannot be regarded as a South African tax resident under any of these two tests (definition of "resident" in section 1 of the Act). In other words, an individual who is either ordinarily resident in South Africa or who meets the physical presence test during a specific year or assessment can be a non-resident due to the DTA tie-breaker clause. South Africa has signed tax treaties with various countries in order to eliminate double taxation of the same income by allocating taxing rights between the source state and the residence state. South Africa is not a member of the Organisation for Economic Cooperation and Development (OECD) but has observer status and most of its treaties follow the OECD Model Tax Convention (MTC) on Income and Capital – including the DTA between South Africa and the UAE (OECD MTC).

The DTA between South Africa and the UAE defines a resident in terms of tax treaties differently. The term "resident" is defined in Article 4(1) as any person who is liable for tax according to the tax laws of a state, whether by residence, domicile or place of effective management. The definition also stipulates that persons who are only liable for tax in a state based on source, will not fall within the scope of "resident" (Article 4(1) of the DTA between South Africa and the UAE; Article 4(1) of the OECD MTC of 2017).

DTA's dictate which country in the agreement enjoys sole taxing rights. Where individuals qualify as a tax resident of both countries under their respective domestic laws, it is referred to as dual residency. Dual residency is resolved by the tie-breaker rules contained in Article 4(2) of the DTA between South Africa and the UAE (Article 4(2) of the OECD MTC). An individual's tax residency status will be determined by a series of steps and criteria, namely:

- Where they have a permanent home. The permanence of the home is the important factor, whether it be a house, rented apartment or even a rented room, as long as it is continuously available to the person (Par. 12 and 13 of the Commentary on Article 4 of the OECD MTC). If they retain a permanent home in both countries, preference will be given to the country where their personal and economic relations are closer (centre of vital interests). A person's centre of vital interests can refer to family, place of business or cultural activities (Par. 15 of the Commentary on Article 4 of the OECD MTC);

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- In cases when their centre of vital interests cannot be determined, where they have a habitual abode suffices. Habitual abode refers to the state or country a person stays in more frequently (Par. 17 of the Commentary on Article 4 of the OECD MTC);

- If a habitual abode is retained in both countries, preference will be given to the country of which they are a national or hold a passport; and

- When they hold a passport of both countries or of neither, the countries will settle the question by mutual agreement.

Once the residence state is determined, Article 14 of the DTA between South Africa and the UAE needs to be consulted to determine which state has the right to tax the employment income (Article 15 of the OECD MTC). Article 14(1) dictates that employment income earned for employment exercised in another country may be taxed in the country of source as well. Both countries (South Africa and the UAE) then have the right to tax. The source state (UAE) will, however, lose its right to tax the employment income if:

- The employee is not physically present in the other country (UAE) for a period exceeding 183 days in any 12-month period ending or commencing in the particular tax year;

- The employer who pays the remuneration, or a representative, is not a resident of the other country (UAE); and

- The remuneration income does not relate to a permanent establishment of the employer in the other country (UAE).

The DTA between South Africa and the UAE does not define "employment" but states that any term not defined therein will adopt the meaning as held in domestic legislation; the same applies to "employee" (Article 3(2); Article 3(2) of the OECD MTC). Paragraph 1 of the Fourth Schedule of the Act defines an employee as any individual who receives remuneration income and an employer as any person who pays the remuneration income. Employment will thus constitute a contractual agreement between an employer and employee, where the employee renders services in exchange for remuneration. According to Article 14(1) of the DTA, the term "remuneration" includes salaries, wages, fringe

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benefits, bonuses, cash and other similar remuneration (Article 15(1) of the OECD MTC). The section 10(1)(o)(ii) exemption defines remuneration differently; this will briefly be discussed.

In the instance where Article 14(2) of the DTA between South Africa and the UAE does not apply and both countries have the right to tax the same employment income, double taxation would have existed had the UAE levied income tax. Article 22 of the DTA addresses the issue of double tax relief and it can be relied on in lieu of domestic relief. However, South Africa has the section 6*quat*(1) rebate in place to prevent double taxation. This rebate allows unused credits to be carried over for a total of seven years until it is fully utilised against taxes payable in South Africa on the foreign income, subject to certain limitations. The section 6*quat*(1C) and (1D) deduction will not apply in this instance as it provides relief for any foreign taxes paid by a resident on any South African sourced income. The definition of "gross income" in section 1 of the Act sets out the income to be included in both a resident and non-resident's taxable income.

2.1.2.2 Gross income

A person's tax status in South Africa determines what needs to be included in gross income. The paragraph (i) of the definition of "gross income" in section 1 of the Act stipulates that the total amount, in cash or otherwise, received by or accrued to a resident, other than of a capital nature, will constitute gross income. In the case of a non-resident, gross income is only the total amount, in cash or otherwise, received by or accrued to a non-resident from a source within South Africa (paragraph (ii) of the definition of "gross income" in section 1 of the Act). Residents are effectively taxed on their worldwide income and non-residents are only taxed on South African source income.

Income from services rendered are regarded as being received from a source outside South Africa if the services are physically rendered abroad (CIR v Lever Bros and Unilever Ltd:23; CIR v Epstein:235). The only relevant factor in determining the source is therefore where the services are physically rendered.

The remuneration income that residents receive from a foreign source will be taxed in South Africa as residents are taxed on their worldwide income and the resident state (South Africa in this instance) has taxing rights under the DTA as previously explained (Article 14 of the DTA between South Africa and the UAE). This remuneration will

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therefore form part of the individual's gross income. Section 10(1)(o)(ii) of the Act does, however, govern an exemption, capped at R1.25 million per year, of this foreign remuneration income, again excluding it in part or in full from taxable income. This exemption can only be utilised once all the requirements are met. These will now be discussed in detail.

2.1.2.3 Section 10(1)(o)(ii)-exemption

Section 10(1)(o)(ii) of the Act governs the exemption of foreign remuneration income as of 1 March 2020. Certain criteria need to be met in order to qualify for this exemption. These criteria will now be discussed in detail.

2.1.2.3.1 Remuneration

Not all remuneration falls within the scope of the exemption. The following amounts will quality for the exemption (section 10(1)(o)(ii)) (SARS Interpretation Note 16 [issue 3]:2-3):

- Salaries and wages;
- Taxable benefits (fringe benefits);
- Leave pay;
- Overtime pay;
- Bonuses;
- Gratuity;
- Fees, emoluments or allowances;
- Amounts derived from broad-based employee share plans; and
- Amounts received in respect of share vesting

It is important to note that only remuneration earned by an employee while rendering services abroad for the qualifying number of days qualifies for the exemption. Days spent abroad while not earning remuneration will fall outside the exemption, as will any remuneration received for services rendered within South Africa. Where remuneration was earned for services rendered within and outside South Africa, the amount earned needs to be apportioned to only allow the amount relating to the foreign services to qualify under the exemption. Any remuneration received after the qualifying period but relating to that

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period, will however still fall under the section 10(1)(o)(ii) exemption (SARS Interpretation Note 16 [issue 3]:2-3). The study will only focus on remuneration in the form of salaries, allowances and fringe benefits but will not include remuneration received from retirement funds.

2.1.2.3.2 Employment relationship

The exemption only applies to the presence of an employer-employee relationship. These employers may be resident or non-resident employers, as long as the services are rendered abroad under an employment contract (section 10(1)(o)(ii)) (SARS Interpretation Note 16 [issue 3]:3).

The term "employee" excludes self-employed individuals or independent contractors under common law. Directors are regarded as holders of an office and therefore not employees. Any director's fees will therefore also not qualify for the exemption (SARS Interpretation Note 16 [issue 3]:3).

2.1.2.3.3 Services rendered

Any remuneration received must be for services rendered and may not relate to the termination of employment or a restraint of trade (section 10(1)(o)(ii)) (SARS Interpretation Note 16 [issue 3]:3).

2.1.2.3.4 Outside South Africa

The employment services need to be physically rendered outside the Republic. Section 1 of the Act defines the "Republic" as the landmass of South Africa, as well as its territorial waters. Lesotho and Eswatini may fall within South Africa's landmass but do not form part of the Republic of South Africa (section 10(1)(o][ii]) (SARS Interpretation Note 16 [issue 3]:3-4).

2.1.2.3.5 Days test

For the exemption to apply, an individual needs to be physically present outside South Africa for more than 183 full days in total (of which more than 60 full days must be continuous) during a 12-month period. These 12 months may be any 12 consecutive months starting or ending in the relevant year of assessment, may start on any day of the

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month and are not necessarily fixed to a calendar year or tax year (SARS Interpretation Note 16 [issue 3]:6) A "full-day" constitutes the full 24 hours of a day; taking into consideration calendar days, not only working days. A part of a day will not contribute to the calculation of days spent abroad. A day in transit through South Africa but where the country has not been officially entered through passport control, will be deemed as a day spent outside the Republic (proviso (A) to section 10(1)(o)(ii)). It is important to note that weekends, public holidays, vacation and sick leave days are taken into account for the 183/60 day count, as long as they were spent outside the Republic whilst employed. Days spent abroad but not whilst under an employment contract, will not qualify as days outside the Republic for means of this requirement (section 10(1)(o)(ii)(aa) and (bb)) (SARS Interpretation Note 16 [issue 3]:5-7).

2.1.2.3.6 Exclusions to the exemption

Certain types of employees are excluded from the exemption, even though they might meet the 183/60 days outside the Republic requirement and are also excluded from this study. These employees include (proviso (B) to section 10(1)(o)(ii)) (SARS Interpretation Note 16 [issue 3]:8):

- A holder of a public office as appointed under an Act of Parliament (Section 9(2)(g)),
- Employees employed in the local, provincial or national sphere of government (such as ambassadors and diplomats), national and provincial public entities, certain constitutional institutions and municipal entities (Section 9(2)(h)), and
- Self-employed individuals and independent contractors.

Residents will need to substantiate their claim for the exemption. Relevant documentation will need to be provided to SARS to prove the time spent abroad under an employment contract and that it was for services rendered under employment. This documentation may include but is not limited to stamped passports, employment contracts and secondment letters (SARS Interpretation Note 16 [issue 3]:5). The following figure sets out the steps to qualify for the exemption visually.

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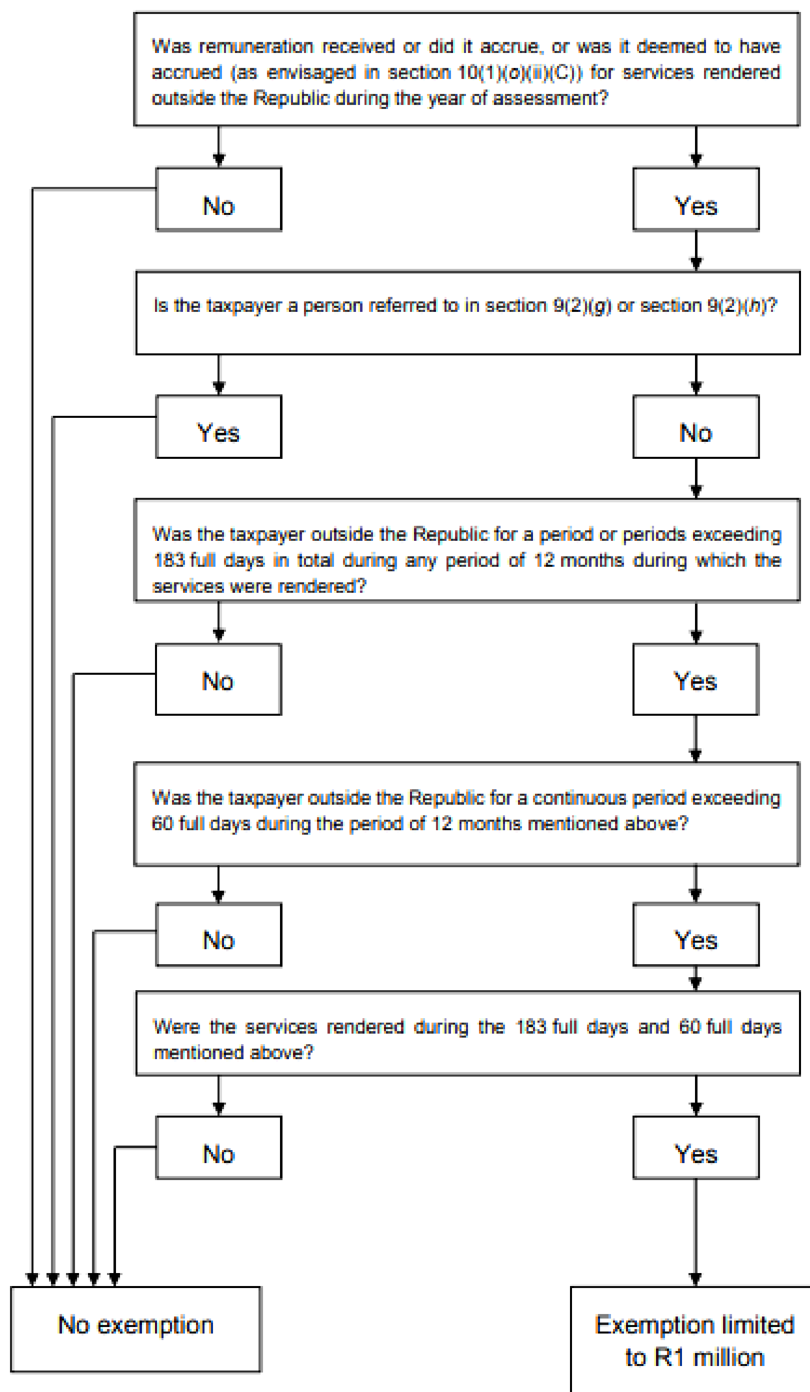

Figure 2: Section 10(1)(o)(ii) exemption

Source: SARS Interpretation Note 16 (issue 3):18 (2020)

South African residents who qualify for the R1.25 million exemption will now only be taxed on their foreign remuneration income in excess of the R1.25 million as from 1 March 2020 (SARS Interpretation Note 16). It is, however, important to note that only the remuneration earned abroad for services rendered during the particular 12-month period may be exempt from normal tax in South Africa. If remuneration is earned for services rendered both within

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South Africa and abroad, the remuneration needs to be apportioned according to the number of workdays physically spent outside South Africa. "Workdays", for purposes of this apportionment, exclude leave days, weekends or public holidays. Only remuneration relating to services rendered abroad will qualify for the section 10(1)(o)(ii) exemption, limited to R1.25 million per year of assessment. If the services rendered inside South Africa are regarded as merely accidental or casual, the services will still be deemed as being rendered abroad. Service remuneration received at a later date (for example a bonus) but relating to more than one year of assessment, will be regarded as having accrued evenly over the periods of service (SARS Interpretation Note 16 [issue 3]:9).

In the instance where the excess remuneration above the R1.25 million exemption is taxable in both South Africa and another country, South Africa as the resident country provides relief from double taxation in the form of a rebate. South Africa provides unilateral tax relief from double taxation in its domestic law under section 6*quat* of the Act (SARS Interpretation Note 18 [issue 4]:6). Section 6*quat*(1) provides for a deduction of foreign taxes payable on foreign-sourced income against the South African tax levied on the same income. "Income" as defined in section 1(1) refers to the amount of gross income remaining after the deduction of any exempt amounts. Only amounts still taxable in South Africa, after the exclusion of any exempt amounts (under the section 10(1)(o)(ii) exemption), will qualify for a tax rebate under section 6*quat*(1) (SARS Interpretation Note 18 [issue 4]:10). The rebate under section 6*quat* is limited to the amount of foreign tax proved to be payable in the other country (section 6*quat*(1A)) and may not exceed the amount of normal tax payable in South Africa on foreign-sourced income. Any excess may be carried forward for up to seven years (section 6*quat*(1B)). The section 6*quat* rebate will however not apply to remuneration income received from services rendered in the UAE as the UAE does not levy income and no double tax arises.

Expatriates who still fall within the expat tax net, after considering the section 10(1)(o)(ii) exemption, will need to review their options. The following section will provide a description of these.

2.1.3 Options available to residents

The newly imposed expat tax has many South Africans backed up against a wall. The uncertainty for these individuals is what their next step should be in counteracting this

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legislation (Ryan, 2020). This tax will have hard-hitting consequences for any expatriate working abroad and who has relied on the full exemption under section 10(1)(o)(ii) up until 29 February 2020 (Oostingh, 2019:5). It is estimated that over 100 000 South Africans live in Dubai alone, most of whom will earn remuneration income in excess of R1.25 million a year (Ryan, 2020).

Although many perceive the exemption threshold to be generous, it will in reality be reached quite quickly. The remuneration income that qualifies for the exemption includes not only cash salaries. It also includes benefits such as housing, school allowances and all fringe benefits, for example, annual return air tickets home for the taxpayer and their family (Ryan, 2020; My Broadband, 2019; Oostingh, 2019:5). Expatriates working in the Middle East may not have paid income tax on their remuneration income abroad but their living expenses quite probably make up the difference (Ryan, 2020). The cost of living in Dubai (UAE) is on average 95% higher than that of Johannesburg, South Africa (Expatistan, 2020). Some of these living expenses may be borne by employers of expats, constituting a taxable fringe benefit for South African tax purposes.

Many South African expats may resort to drastic measures to escape expat tax. Some motivations for expats to act upon the imposed tax are the lack of job opportunities and crime in South Africa, forcing them to seek employment overseas. The cost of living in these overseas countries is often much higher than in South Africa. Furthermore, there is a failing trust in the South African government and a reluctancy to pay additional or higher taxes by already overly-taxed individuals (Business Tech, 2019d; Du Preez and Stoman, 2019; My Broadband, 2019; New World Immigration, 2020; Oberholzer and Stack, 2014).

Residents have several options at their disposal in response to the imposed expat tax. Most South Africans are advised to simply formally emigrate (FinGlobal, 2020). Chairman of the Sovereign Trust SA, Tim Mertens, believes that expatriates earning high above the R1.25 million threshold are more likely to financially emigrate (Ryan, 2020). This option may however be ill-advised if all consequences of financial emigration are not considered, especially exit tax (FinGlobal, 2020; Retief, 2019). Furthermore, formal emigration *per se* does not necessarily indicate the ceasing of ordinarily residence in South Africa (Van Zyl, 2020).

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There are other options, however. These include (iAfrica, 2020; Oostingh, 2019:5):

- Do nothing;
- Move back to South Africa;
- Set up a foreign entity;
- Financially emigrate;
- Cease South African tax residency (other than through financial emigration); and
- Other options.

Each option will now be discussed in more detail.

2.1.3.1 Do nothing

Some expatriates might just bite the bullet and pay the tax without applying any tax planning. Doing nothing in reaction to the imposed expat tax will result in higher tax and less money in their pockets, not to mention the admin cost and burden of filing returns.

2.1.3.2 Move back to South Africa

Most South Africans cannot imagine winding up their work abroad and moving back to South Africa (Davis, 2019). Many expatriates left the country in search of greener pastures in the form of work opportunities that were not available in the country. They would now not be able to maintain their lifestyles in South Africa's crumbling economy (iAfrica, 2020).

Expatriates moving back to South Africa would need to reapply for work. The most recent publication by Stats SA on South Africa's unemployment rate for the first quarter of 2020 indicated an unemployment rate of 30.1%. This statistic was only gathered for the three months up until March 2020 – which was before the nationwide Corona-19 lockdown. These figures are set to worsen with the pandemic (Business Tech, 2020), leaving expats with little hope in their job search.

2.1.3.3 Set up a foreign entity

Setting up a tax-efficient structure to limit one's tax liability is an option available to expatriates. This structure may aid in protecting foreign income and assets, especially if set up in a tax-friendly jurisdiction. An offshore professional services entity may, for

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instance, invoice an international employer but the tax jurisdictions of each country in the transaction would need to be considered to ensure that it will indeed be a tax-efficient transaction (iAfrica, 2020).

This option will require careful consideration as to avoid the controlled foreign company (CFC) anti-avoidance rules applicable in South Africa. A CFC exists when one or more South African residents directly or indirectly hold more than 50% of the shares in that company (definition of "controlled foreign company" as in section 9D(1) of the Act). The CFC rules then dictate that the net income of that CFC needs to be accounted for in the hands of its South African shareholders for tax purposes (section 9D(2)). These are complex requirements and will be costly as expert advice will be required. This option will not be discussed further in this study.

2.1.3.4 Financially emigrate

Formal emigration is the process of changing your status as a South African resident to that of an emigrant with the South African Reserve Bank (SARB). This is merely an exchange control procedure and the individual retains his or her South African citizenship (and passport) with the Department of Home Affairs. Most importantly, the individual could also remain a South African tax resident (Retief, 2019; Ward, 2019). Many perceive formal emigration as a way to end their South African tax residency but it is erroneous (Ward, 2019). Formal emigration is only successful as a measure to avoid expat tax if an individual's tax residency is indeed also ceased in the process. It is then referred to as financial emigration. Formal emigration is therefore only one of the factors to consider in determining whether a person is still ordinarily resident in South Africa. If, for example, a person retains a holiday home in South Africa and visits it annually for a family vacation, it could indicate that South Africa is still the place to which the person would return after their travels (Visser, 2019).

Assuming a high net-worth individual can successfully change their tax status to a non-resident with financial emigration, it may still not result in material tax savings with the "exit tax" looming overhead (Retief, 2019). The so-called "exit tax" refers to the income tax implications (especially CGT) relating to a person's cessation of their tax residency (Investec, 2019). Section 9H of the Act stipulates that an individual will be deemed to sell

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all of their worldwide assets at market value on the day immediately preceding the day of cessation.

Section 9H(4) provides for exclusions to the deemed disposals. Section 9H does not apply to immovable property held in South Africa and any asset linked to a permanent establishment in South Africa. Any disposal of these assets in future will remain in the South African tax net, being from a South African source and therefore no deemed disposal occurs (section 9(2)(j) and (k); paragraph 2(1)(b) of the Eighth Schedule to the Act; SAICA, 2013). Deemed disposals under section 9H, will trigger normal tax (including CGT-implications) in South Africa. Individuals with a capital gain are entitled to a R40 000 annual exclusion (par 5(1) of the Eighth Schedule), which is thereafter included in taxable income at a rate of 40% (par 10(a) of the Eighth Schedule). The gain will in effect be taxed at a maximum effective rate of 18% (40% at 45%). Exit tax could therefore have dire financial consequences for individuals looking to financially emigrate (Investec, 2019).

As already mentioned, any disposals of immovable property located in South Africa after ceasing to be a resident will trigger CGT. Section 35A(1) of the Act requires the purchaser to withhold a portion of the purchase price and pay it over to SARS. This is not a final tax but rather an advance payment towards the normal tax liability of the non-resident arising as a result of the sale. It is also important to note that the deceased estate of an individual who was ordinarily resident in South Africa at the time of death, will still be liable for estate duty on worldwide assets held by the deceased at death (SARS, 2020d). This will also be the case when an expat is still an ordinary resident in South Africa but is deemed to be a tax resident of another country under the DTA. Being ordinarily resident is the ball-and-chain of any South African trying to avoid South African taxes.

Formal emigration is perceived as the very last step in ceasing tax residency, as it is only an exchange control provision (Retief, 2019). It is also important to note that formal emigration will be regarded as a failed emigration if the person returns to South Africa within five years after formally emigrating. However, as already mentioned, formal emigration will be phased out by 1 March 2021 (National Treasury, 2020a; Visser, 2020).

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2.1.3.5 Cease South African tax residency (other than through financial emigration)

By ceasing tax residency, individuals can escape expat tax (Retief, 2019). It may even not be necessary to formally emigrate (Hogg, 2019b). A person can cease to be a tax resident of South Africa in one of four ways, namely:

- ceasing to be ordinarily resident in South Africa by conveying an intention to become ordinarily resident in another country, with steps indicative of this intention having been carried out (SARS Interpretation Note 3 [issue 2]:5); or
- if not ordinarily resident in South Africa at all during the relevant year of assessment, failing to meet all three requirements of the physical presence test (SARS Interpretation Note 4 [issue 5]:2);
- if not ordinarily resident in South Africa but meeting all the requirements of the physical presence test during a year of assessment, an individual ceases to be a resident once a continuous period of 330 days is spent abroad (SARS Interpretation Note 4 [issue 5]:6). To gain residency again, all the requirements of the physical presence test need to be complied with in the next year of assessment (SARS Interpretation Note 4 [issue 5]:5); or
- deemed to be exclusively a resident of another country under the tie-breaker clause of a DTA (definition of "resident" in Section 1 of the Act).

Under all four possibilities, the natural person will be taxed on a worldwide basis whilst a resident and a source basis upon becoming a non-resident and thereafter. The date on which the change from resident to non-resident takes place is, however, different for each of the possibilities:

- A resident will cease their tax residency on the day they no longer ordinarily reside in South Africa (SARS Interpretation Note 3 [issue 2]:7),
- If failing to meet all three requirements of the physical presence test, they will cease to be a resident on the last day of the previous year of assessment (SARS Interpretation Note 4 [issue 5]:5);
- If the physical presence test was met for a specific year of assessment and the person leaves South Africa during that year and is absent for a continuous period of at least 330 full days, they will be a non-resident from the day they leave South Africa until the last day of that specific year of assessment (SARS Interpretation Note 4 [issue 5]:6). In

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the subsequent tax year, their status will be determined by applying the physical presence test again, so they will remain a non-resident for the entire subsequent year - only if they do not meet all three requirements of the physical presence test (SARS Interpretation Note 4 [issue 5]:6); and

- From the day it is established through the tie-breaker rules that they are a resident of another country (Par. 10 of the Commentary on Article 4 of the OECD MTC).

2.1.3.6 Other options

Expats may even resort to drastic and desperate measures to avoid or decrease expat tax, for example (Roos, 2012; Prebble and Prebble, 2010):

- Not registering as a taxpayer in South Africa;
- Not filing income tax returns with SARS;
- Not declaring fringe benefits forming part of remuneration;
- Not volunteering information to SARS if not asked for it in the return (Van Zyl, 2020); or
- Underreporting income by not disclosing all income or exaggeration of expenses (Davis, 2019).

Any of these options mentioned might border on tax avoidance or evasion, depending on the relevant facts and circumstances. These are elaborated on below.

2.2 TAX AVOIDANCE AND TAX EVASION

The Oxford Learner's Dictionary (2020a) defines tax as "a compulsory contribution to state revenue, levied by the government on workers' income and business profits, or added to the cost of some goods, services and transactions". Tax is a common principle practised around the world where governments collect tax revenue to fund essential public services (Kagan, 2019). However, tax evasion is equally common; Oberholzer and Stack (2014) found that tax and evasion go hand-in-hand.

Tax evasion dates back centuries. During the third century, Romans buried their gold coins and jewellery in an attempt to evade luxury tax; homeowners in England temporarily

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bricked up their chimneys to escape hearth tax in the eighteenth century (Slemrod, 2007:25). Times may have changed but one thing is inevitable – tax evasion.

The distinction between tax avoidance and tax evasion needs to be clarified for the study. This will further identify the factors causing tax evasion, establish the presence of tax evasion in South Africa and determine the link between expat tax and tax evasion in South Africa.

2.2.1 Tax avoidance defined

Avoidance in itself is defined as "not doing something; preventing something from existing or happening" (Oxford Learner's Dictionary, 2020b). Dare, Du Plessis and Jansen (2019) define the concept of tax avoidance as when individuals who take advantage of legal loopholes within tax legislation to reduce their tax liabilities. This includes legal tax planning. Tax avoidance is thus the arrangement of one's affairs in a legal manner so as to lower the tax burden (IRC v Duke of Westminster; Prebble and Prebble, 2010).

2.2.2 Tax evasion defined

The Oxford Learner's Dictionary (2020c) defines evade as "to find a way of not doing something, especially something that legally or morally you should do". The term tax evasion could then be defined as the extent to which individuals do not pay the taxes levied by the government by way of deceit (Dictionary.com, 2020b; Venter, 2012; Torgler and Schaltegger, 2006:396). Tax evasion is regarded as criminal fraud (Prebble and Prebble, 2010) and involves some sort of cover-up or scheme (Fuest and Riedel, 2009:5).

There are stages of reaching tax evasion. Whilst tax avoidance is the legal arrangement of affairs to lessen the tax burden, aggressive tax avoidance is the grey area in the middle where loopholes in the legislation are taken advantage of in a manner that is morally questionable. Tax evasion is where the line is officially crossed when tax is illegally evaded through deception, concealment and dubious action (Payne and Raiborn, 2018).

2.2.3 Factors causing tax evasion

Cummings *et al.* (2009:456) state that tax evasion is a decision made based on various factors. This was seconded in the study conducted by Venter (2012) regarding the factors influencing tax evasion. Most of these factors prevail globally. This study will explore these

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factors to determine if any of the actions taken by expats to counteract expat tax are or will be based on some of these factors identified by prior studies. The various factors that were identified in previous studies as causing tax evasion in South Africa can be classified into three categories. They are discussed below.

2.2.3.1 Psychological factors

The most influential psychological factors are the perceptions that individuals have of government, its fairness (Oberholzer and Stack, 2014; Jackson & Milliron, 1986), effectiveness, capacity to correctly and fairly apply funds and its work for the common good (Oberholzer, 2008a). The government is responsible for supplying public services, upholding the law, ensuring a low unemployment rate and a low inflation rate (Dell'Anno, 2009). The complexity of tax legislation and the continuous change thereof, is also a substantial factor of tax evasion (Nugent, 2013; Jackson and Milliron, 1986); this adds to the lack of tax knowledge (Oberholzer and Stack, 2014).

The perception of individuals of the fairness of paying taxes contributes to tax evasion (Delport, 2003; Richardson and Sawyer, 2001:291-295; Jackson and Milliron, 1986), as does their morale towards paying tax (Kemme, Parikh and Steigner, 2020; Lewis, 1982). Therefore, coming in close contact with SARS and having a high regard of the revenue authority influences compliance (Oberholzer, 2008a), as does the preparedness of individuals in taking risks (Toynbee, 2015; Dean, Keenan and Kenney, 1980). Religion can also play a role (Torgler and Schaltegger, 2006:410).

2.2.3.2 Economic factors

Economic factors include high tax rates (Torregrosa-Hetland, 2020; Feinstein, 1991:15), the probability of detection and severity of penalties imposed when caught (Gangl, Torgler, Kirchler and Hofmann, 2014; Allingham and Sandmo, 1972). Other factors include the income level (Torregrosa-Hetland, 2020; Feinstein, 1991:15) and income source of individuals (Marriott, 2017; Wallschutzky, 1984).

2.2.3.3 Sociological factors

Sociological factors include the tax compliance of peers (Sasmaz, 2019; Clotfelter, 1983:354), education (McGee and Ross, 2014; Jackson and Miliron, 1986), age (Marriott,

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2017; Feinstein, 1991:15), gender (D'Attoma, Volintiru and Steinmo, 2017; Baldry, 1979) and marital status (Mcgee, 2012; Feinstein, 1991:15).

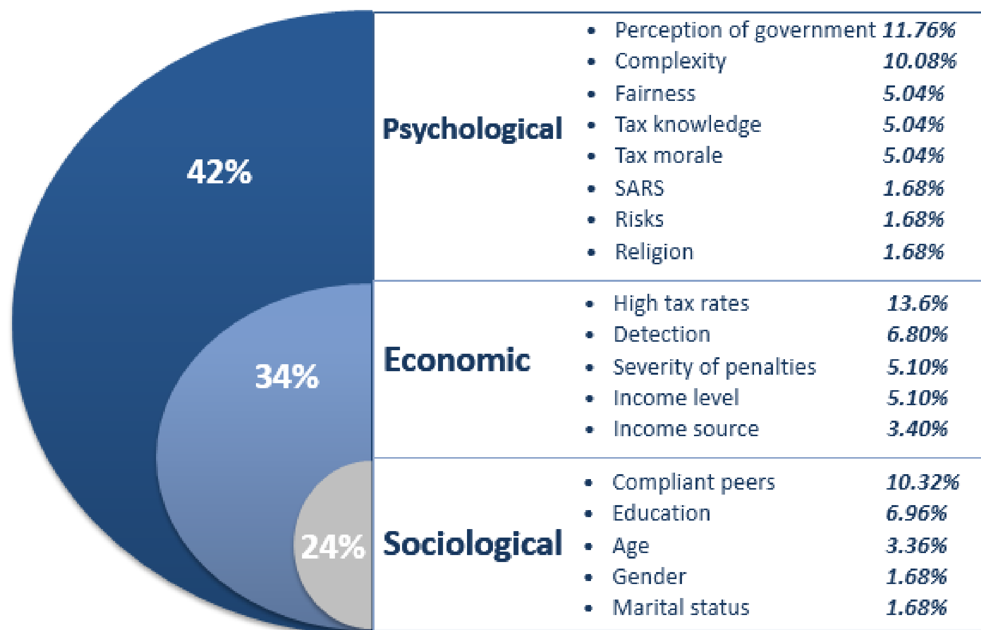

Figure 3: Tax evasion factors in descending order

Source: Ferreira (2017)

The figure above illustrates the different factors causing tax evasion, classified under psychological, economic and sociological factors and the weight of each in descending order. Psychological factors are the biggest (42%), followed by economic (34%) and lastly sociological factors (24%) (Ferreira, 2017).

Tax evasion is a gamble (Allingham and Sandmo, 1972). It is a dangerous game of cause and effect where individuals weigh up their possible winnings against the probability of being caught (Cowell, 1990). People are creatures of greed (Webley *et al,* 1991). Tax authorities heavily penalise this form of criminal fraud but to no avail (Prebble and Prebble, 2010).

A prior study conducted by Ali, Fjeldstad and Sjursen (2014) found that 49% of South Africans find tax unaffordable and that 23% of tax evasion is due to government corruption, poor public services and mismanagement of funds. The researcher's own previous study determined that the two main factors of tax evasion in South Africa are that of high tax rates and taxpayer perceptions of government (Ferreira, 2017). Figure 3 above illustrates these findings, with high tax rates contributing 13.6% and taxpayer perceptions

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of government contributing 11.76% to tax evasion in South Africa. These factors still prevail today; both factors are perceived as the biggest possible causes of a future tax revolt in South Africa (Business Tech, 2019a; Du Preez and Stoman, 2019; The Conversation, 2019). The 'perception of government'-factor might even have surpassed 'high tax rates' as a factor of tax evasion in South Africa in recent years.

Each tax evasion factor present in South Africa will be discussed briefly. The two factors that have been identified to play a fundamental role in tax evasion in South Africa will be discussed in more depth, namely: negative perceptions of government under psychological factors and high tax rates under economic factors (Ferreira, 2017). Thereafter the two main factors' application in a South African context will be discussed with specific reference to expat tax.

Psychological factors

Psychological factor: Perceptions of government

The perception that individuals have of their government greatly influences tax evasion in a country. Once individuals believe that the government mismanages and irresponsibly spends their tax money, tax evasion enters the game (Ali, Fjeldstad and Sjursen, 2014; Oberholzer and Stack, 2014; Coetzee, 1993). Citizens often express their dissatisfaction with the government by not complying with tax regulations or even withholding tax payments. This is often referred to as a "tax revolt" (The Conversation, 2019).

Paying tax is generally perceived as a give-and-take arrangement. Individuals pay their tax dues in return for public services. Tax evasion is a common occurrence when this arrangement is skewed (PWC, 2019; The Conversation, 2019; Oberholzer and Stack, 2014). Furthermore, once it is believed that corruption is present within the government, it is 'game over'. Transparency under government spending of tax revenue is an important facet in any tax system (Oberholzer and Stack, 2014). This factor is perceived as the most prominent factor prevailing under South Africans looking to evade tax (Du Preez and Stoman, 2019).

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Psychological factor: Complexity

Most individuals find tax legislation to be overly complex. The more complex tax legislation becomes, together with regular changes, the more opportunities and loopholes are created for tax evasion (Oberholzer and Stack, 2014; Richardson and Sawyer, 2001; Jackson and Milliron, 1986). A recent survey conducted by PWC in South Africa found that 77.2% of taxpayers find tax legislation and SARS processes complex, also suggesting insufficient knowledge amongst taxpayers (PWC, 2019).

Psychological factor: Fairness

A study conducted by Delport (2003) found that the fairness of a tax system affects tax compliance among individuals (PWC, 2019; Richardson and Sawyer, 2001:291-295; Jackson and Milliron, 1986). Once a tax system is perceived as unfair, individuals justify evading tax (Ramfol; 2019b; Webley *et al.,* 1991).

Psychological factor: Tax knowledge

Knowledge of tax workings somewhat affects tax evasion (PWC, 2019; Oberholzer and Stack, 2014). Bonjean and Chambas (2004) stated that most non-compliant individuals are just ignorant of tax regulation. Tax knowledge may also include knowledge on evading tax by finding loopholes in legislation. There are simply too many loopholes available to abus e (Business Tech, 2017; Jackson and Milliron, 1986).

Psychological factor: Tax morale

Tax morale entails the attitude of individuals towards paying tax (OECD, 2019). When tax morale amongst individuals runs low, they tend to express their antipathy towards the government in the form of tax evasion (Kemme, Parikh and Steigner, 2020; Lewis, 1982).

Psychological factor: SARS

Coming in close contact with and high regard of SARS breeds tax compliance (Lewis, 1982; Feld and Frey, 2002; Oberholzer and Stack, 2014). Distrust and doubt in the credibility of SARS contributes to taxpayer non-compliance (Williams, 2018).

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Psychological factor: Risks

Individuals wish to beat the system by way of tax evasion (Oberholzer and Stack, 2014; Dean *et al.,* 1980). The risk of getting caught, penalties and the expected gain is weighed up (Richardson, 2006); since tax evasion is perceived as a gamble (Allingham and Sandmo, 1972). The stakes of this gamble are becoming increasingly high as SARS plans to better 'nail' tax dodgers (De Villiers, 2020).

Psychological factor: Religion

Religious people tend to be more ethical and thus more tax compliant. This is irrespective of the religion that they follow (Mcgee and Benk, 2019; Venter, 2012).

Economic factors

Economic factor: High tax rates

Very high tax rates may cause rebellion against the government (Business Tech, 2019a). Individuals perceive high tax rates as unaffordable and unjust (Torregrosa-Hetland, 2020; Ali, Fjeldstad and Sjursen, 2014), especially when citizens do not receive decent public services in return for their tax money (Oberholzer, 2008b). High tax rates are perceived as one of the biggest motivations for rebellion against tax in South Africa. Residents are being weighed down and taxed into poverty. South Africa's personal income tax is ranked eighth highest in the world in 2018, just after Germany (Business Tech, 2018b):

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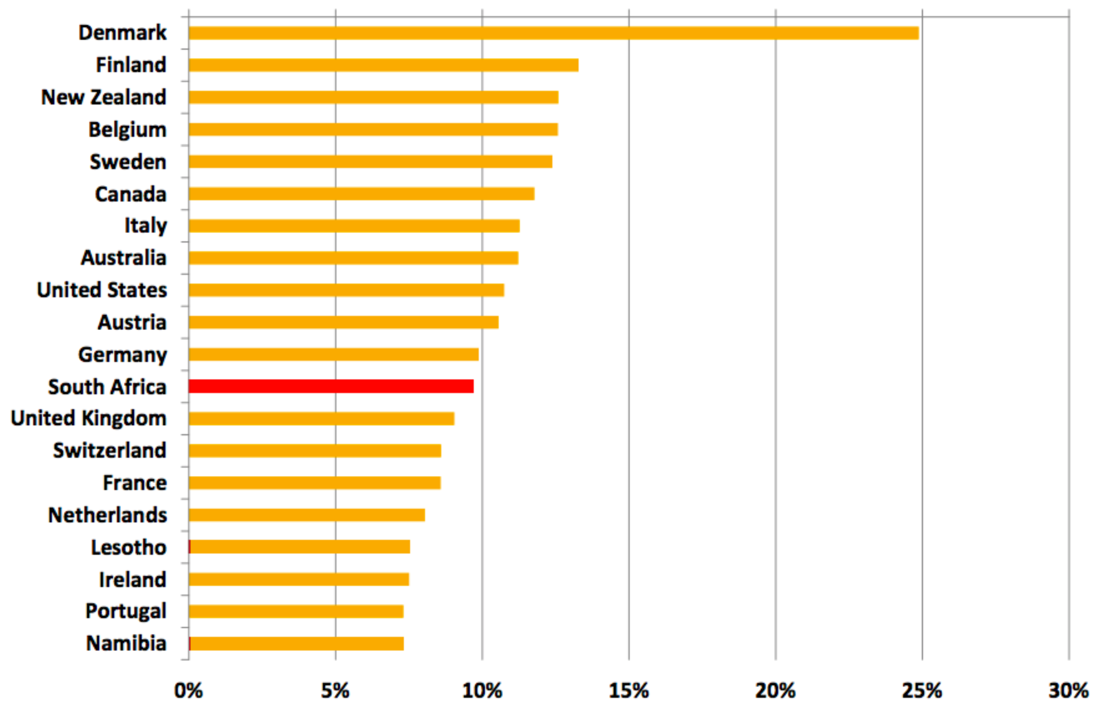

Figure 4: Highest personal income tax burdens in the world

Source: Business Tech (2018b)

Tax takes a big slice out of a taxpayer's pie. Not only are South Africans accustomed to paying a lot of tax but also to funding educational, medical and security expenses from the little money they have left after tax, as the government does not use taxes to cover these expenses for its citizens (Coetzee, Du Preez and Mather, 2014). Individuals earning remuneration from employment have nowhere to hide from the taxman, as tax is already withheld from salaries by employers (SARS, 2020c).

A theory, namely the Laffer Curve, illustrates the relationship between tax rates and tax revenues. Arthur Laffer, the theorist of the curve, wanted to illustrate that lower tax rates may, in fact, yield higher tax revenues and that as tax rates rise beyond a certain point, tax revenues start decreasing (Domitrovic, 2019). The following figure illustrates the phenomenon depicted by Arthur Laffer.

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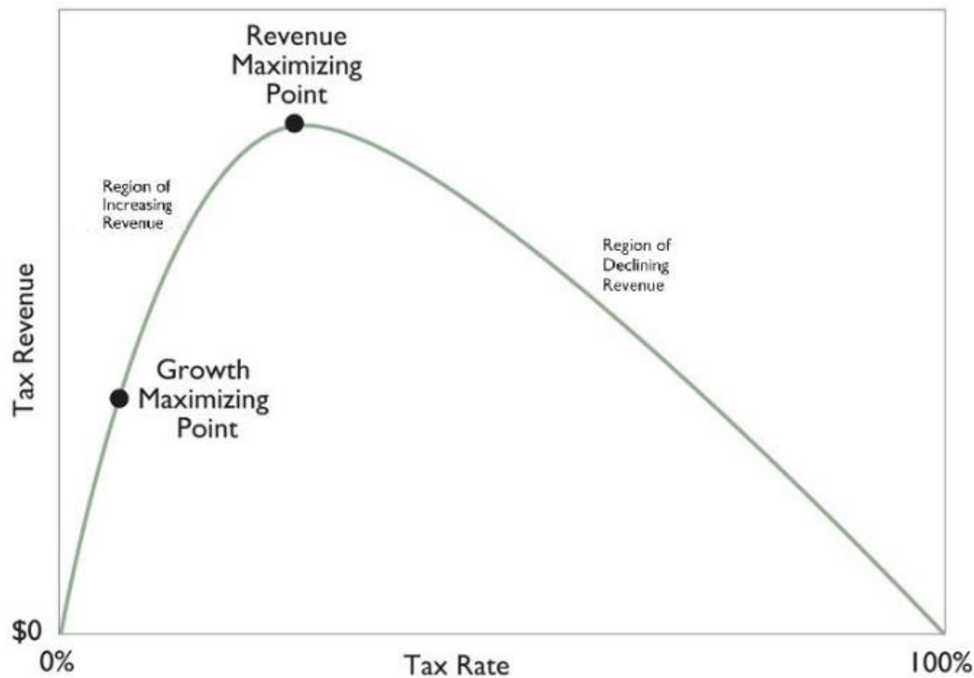

Figure 5: The Laffer Curve

Source: Mitchell (2014)

From Figure 5, it is clear that taxpayers perceive a tax rate as fair once their tax contributions equal the benefits they receive, illustrating the "revenue maximising point" (Du Preez and Stoman, 2019). The "growth maximising point" is where tax rates are set to maximise government growth, which is ideal but almost impossible to maintain (Mitchell, 2012).

Economic factor: Detection

Individuals tend to weigh up the probability of detection to find the odds in their favour (Allingham and Sandmo, 1972). Webley *et al.* (1991) found that greater opportunities and gains lead to increased tax evasion (Gangl *et al.,* 2014). Therefore, SARS plans to sharpen their tax evasion detection procedures over the next few years, increasing the likelihood of detection (De Villiers, 2020).

Economic factor: Severity of penalties

Slemrod (2007) found that individuals tend to be more compliant when severe penalties are enforced by tax authorities. The severe penalties imposed by SARS should be enough to deter any tax dodger (Business Tech, 2018c).

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Economic factor: Income level

It is perceived that low- and high-income earning individuals are more likely to evade tax than the middle-class (Torregrosa-Hetland, 2020; Jackson and Milliron, 1986). High-income earners have more opportunities in evading tax by, for example, using tax havens, (Torregrosa-Hetland, 2020; Lewis, 1982). They also receive fewer state benefits for their money (Vogel, 1974). In turn, people in financial hardship are perceived as more tax evasive (Oberholzer and Stack, 2014).

Economic factor: Income source

Individuals subject to withholding tax in the form of PAYE (pay-as-you-earn) on their salaries are generally more compliant compared to when third parties withhold this tax (Dare, Du Plessis and Jansen, 2019). It is found that self-employed individuals are more likely to complain about tax rates being too high (Vogel, 1974), although the informal sector is more likely to abuse the system and succumb to tax evasion (Joshi, Prichard and Heady, 2012).

Sociological factors

Sociological factor: Compliant peers

Kirchler (2007) recorded herd behaviour amongst people, especially regarding tax evasion. Tax evasion may become a general practise among peers making it a social norm, especially when determining the perceived likelihood of detection (Sasmaz, 2019; Gcabo and Robinson, 2007:362; Fjeldstad and Semboja, 2001:2061; Clotfelter, 1983:354). Peers who are known to escape their tax obligations may spark optimism (Ferreira, 2017).

Sociological factor: Education

Oberholzer and Stack (2014) found that higher educated individuals tend to be more tax compliant than the less educated. This is because they are more aware of the possible consequences when evading tax (Junpath, Kharwa and Stainbank, 2016; Ross and McGee, 2012; Oberholzer, 2008a).

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Sociological factor: Age

Younger individuals (21-29 years of age) are more likely to succumb to tax evasion as they are more willing to take risks (Marriott, 2017; Ross and McGee, 2012; Feinstein, 1991:15; Webley *et al.,* 1991). This was also confirmed by Oberholzer and Stack (2014), who found that older individuals are less likely to evade tax due to receiving additional exemptions and rebates because of their age (Hofmann, Voracek, Bock and Kirchler, 2017).

Sociological factor: Gender

Baldry (1979) found that women are considerably more tax compliant than men (Hofmann *et al.,* 2017). D'Attoma, Volintiru and Steinmo (2017) confirmed this finding in their own study.

Sociological factor: Marital status

Tax compliance findings based on marital status varied across studies. Feinstein (1991:15) found that married couples tend to be more tax evasive but this statement was later countered (Mcgee and Benk, 2016; Ross and Mcgee, 2012).

Each of these factors influences tax evasion, although some carry more weight than others. Many individuals believe that tax can be circumvented and that they are justified in doing so, to the dismay of all tax authorities, with SARS being no exception (Business Tech, 2019b; Ferreira, 2017).

2.2.4 Tax evasion in South Africa

A study conducted by Ali, Fjeldstad and Sjursen (2014) found that only 57% of South Africans are tax compliant, while Oberholzer and Stack (2014) recorded that 21% of South Africans consider evading tax in the future. These statistics showcase the dire state that South Africa's tax system was and still appears to be in.

South African tax revenue has long been crippled by tax evasion. All the identified factors leading to tax evasion are present in South Africa but some carry more weight than others. It is no secret that the country's economy is failing, especially when looking at the unemployment rate of 30.1% (pre-Covid-19, as this figure is rapidly climbing due to the pandemic (Eyewitness News, 2020)) and the allegations of corruption under government

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officials (Business Tech, 2020; Ramfol, 2019a; Oberholzer, 2008a). Once residents of a country catch a whiff of government ill-spending of public finances, with barely any public services being delivered in return for tax money paid, the perception of residents regarding the government turn sour. Another sensitive subject for South Africans is the all-rising tax rate being levied on already overly-taxed individuals (Business Tech, 2019d; Du Preez and Stoman, 2019; New World Immigration, 2020; My Broadband, 2019; Oberholzer and Stack, 2014). A combination of these two factors may be lethal to a country's economy and tax revenue (Smith, 2019).

South Africans have a negative attitude towards paying tax for various reasons. As South Africans' attitude towards paying tax deteriorates, it exacerbates the government's shortage of funds to deliver public services to citizens. This in turn again flames the negative attitude – kick-starting a snowball-effect (Ferreira, 2017). The fact that government practises careless spending and corruption (Oberholzer, 2008a), whilst not maintaining the economy which has now been degraded to junk-status (Wallace, 2020; Dell'Anno, 2009), actually encourages individuals to express their antipathy towards government by committing tax evasion (Kemme, Parikh and Steigner, 2020; Lewis, 1982).

The study will focus on the two most influential factors that cause tax evasion in South Africa as identified in the researcher's previous study, namely negative perceptions of government and high tax rates (Ferreira, 2017). It will attempt to determine whether these two factors are indeed still present in South Africa. Later, the study will determine whether the same two factors will be present amongst South African expats when practising the options available to them in countering expat tax.

Individuals' belief that the government mismanages and irresponsibly spends tax money is perceived as the leading cause of tax evasion in South Africa (Du Preez and Stoman, 2019; Oberholzer and Stack, 2014; Coetzee, 1993). Ali, Fjeldstad and Sjursen's (2014) study found that 23% of tax evasion in South Africa is due to government ill spending and poor public service delivery. Oberholzer and Stack (2014) recorded that 38% of South Africans feel that paying tax is unreasonable given the poor public service delivery; that 58% of individuals believe that the government mismanages tax money and that 88% believe the government is guilty of corruption. Individuals require transparency from government in their spending of tax revenue and 52% of individuals conveyed this concern

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(Oberholzer and Stack, 2014). This perception of government gives individuals the sense that evading tax is justified (Smith, 2019).

The government loses billions of Rands a year due to tax evasion, this is showcased by the almost R50 billion tax gap recorded by Ensor (2019). SARS commissioner, Edward Kieswetter, even expressed his concerns of the government being starved of vital cash flow in this regard (Smith, 2019). Adams (1921) stated that the success of government and economic growth rely on the truthfulness of its citizens; the government and SARS thus heavily rely on this truthfulness (Davis, 2019).

It is this distrust of government that sparks a possible tax revolt. Revolt refers to an act of rebellion against authority and a refusal to obey or conform (Lexico, 2020). The term tax revolt thus refers to the rebellion against the government and its ability to manage tax money for the greater good of its citizens (The Conversation, 2019). A tax revolt is further defined as a rebellion caused when a tax regime is perceived as unfair and oppressive, it is also a mechanism for citizens to renegotiate terms (The Conversation, 2019). The South African public has recently voiced its concerns regarding dissatisfaction with government mismanagement of public finances by threatening them with a tax revolt (The Conversation, 2019). Individuals have become increasingly restive about donating taxes to a corrupt government, as they feel there is no *quid pro quo* (The Conversation, 2019). Another factor that may trigger a tax revolt in South Africa is the exceptionally high tax rates (Business Tech, 2019a). The Conversation (2019) perfectly summed up the reasons for a tax revolt in the country:

> *South Africa's current economic, political and social context presents many factors of taxpayer resistance: a high tax burden; loss of confidence, credibility and competency in government; low taxpayer morale; and increased frustration from government's lack of commitment to arrest the rampant corruption and misappropriation of tax funds*.

Government's response to the current Covid-19 pandemic and alleged corruption also worsened morale amongst taxpayers, who are now considering withholding tax money (Head, 2020). A recent poll conducted by Sakeliga found that many South Africans are considering a tax revolt to try and "save" South Africa (Boucher, 2020). A tax revolt may be executed by either not paying tax or manipulating taxes that are due to SARS (Smith,

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2019). Embarking on a tax revolt is, however, an act of civil disobedience and unlawful. It is, in essence, tax evasion (The Conversation, 2019).

A study conducted by Ali, Fjeldstad and Sjursen (2014) found that 49% of South Africans felt that tax is unaffordable, while another study conducted by Oberholzer and Stack (2014) recorded that 77% of individuals raised their need for tax rates to be lowered. When considering South Africa's high tax rates, the Laffer Curve's effect is already evident in South Africa - tax revenue has declined even though the tax on personal income, profits and capital gains have been raised. South Africa is likely far past the point of maximum revenue return and no further increases in tax revenue can be expected. This places SARS in a difficult situation.

The Income Tax Act (1962) provides SARS with the means of determining whether an individual entered into an impermissible tax avoidance arrangement (sections 80A to 80L). If so, section 80B(1) contains remedies available to SARS, referred to as the so-called general anti-avoidance rules (GAAR). If individuals are found guilty of entering into an arrangement with the sole or main purpose of avoidance by reducing or postponing their tax liability, they may be subject to harsh penalties. The GAAR evaluates the degree of tax evasion; whether tax planning went over to aggressive tax planning and tax evasion. Although these provisions may aid tax authorities to punish those guilty of tax evasion, many still slip through the cracks as evident from the high tax gap in South Africa.

The tax evasion factors present in South Africa will now be applied to the options at the disposal of expats in reaction to the implementation of expat tax, to determine whether they will indeed contribute to tax evasion.

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CHAPTER THREE: EXPAT TAX AND TAX EVASION

3.1 INTRODUCTION

The study has thus far reached its set objectives of explaining the extent of expat tax, as well as briefly discussing the factors that cause tax evasion in South Africa and identifying the two most influential factors, namely taxpayers' perception of government and high tax rates. These two factors' impact in South Africa were then discussed and their contribution to tax evasion showcased. SARS does, however, have section 80A to 80L at its disposal in combatting tax evasion. This chapter will try to determine whether the options available to South African expats in response to expat tax will give rise to tax evasion, specifically looking at the two most influential tax evasion factors present in South Africa.

3.2 LINK BETWEEN EXPAT TAX AND TAX EVASION

It is recorded that personal income tax is the largest contributor (38.3%) (SARS, 2019) to national tax revenue in South Africa for 2019 (Business Tech, 2019a). However, only a few individuals carry this heavy load. Individuals who earn more than R1.5 million per year are expected to contribute R149.6 billion towards the budgeted R546.8 billion personal income tax collection during the 2021 tax year. This represents 27.4% of total personal income tax expected to be collected from 1.7% of all tax registered individuals (National Treasury, 2020b).

High-net worth South Africans are hastily "internationalising" themselves and their wealth by acquiring secondary citizenships or residency and investing abroad. South Africa has experienced a 70% increase in emigration enquiries in 2019 and expects a further increase (Smith, 2019). South Africa's tax base is already small. With a total estimated population of 58.8 million in 2019, where only 21 million are registered for tax and only 36% of the population carries the tax burden (SARS, 2019; Stats SA, 2019). All expatriates may not fall within the "high-income earning" bracket but those that do are most likely to flee (Bloomberg, 2020; Goncalves, 2020; Business Tech, 2019c). The following table illustrates SARS's reliance on high-income earning individuals for personal income tax revenue collection in 2021:

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Table 1: Estimated personal income tax contribution for 2021

Taxable bracket	Registered individuals		Taxable income		Income tax payable before relief		Income tax relief after proposals		Income tax payable after proposals	
R thousand	Number	%	R billion	%	R billion	%	R billion	%	R billion	%
R0 - R80[1]	6 822 326	–	218.8	–	–	–	–	–	–	–
R80 - R150	2 084 683	29.2	235.3	9.3	23.8	4.2	-1.4	10.2	22.4	4.1
R150 - R250	1 771 582	24.8	354.3	14.1	30.9	5.5	-2.1	14.8	28.8	5.3
R250 - R350	1 071 402	15.0	318.3	12.6	47.2	8.4	-2.0	14.0	45.3	8.3
R350 - R500	1 029 509	14.4	424.1	16.8	81.0	14.4	-2.8	20.0	78.2	14.3
R500 - R750	615 177	8.6	368.2	14.6	90.4	16.1	-2.5	17.6	87.9	16.1
R750 - R1 000	266 169	3.7	225.7	9.0	65.9	11.8	-1.3	9.6	64.5	11.8
R1 000 - R1 500	182 883	2.6	217.2	8.6	71.0	12.7	-0.9	6.6	70.1	12.8
R1 500 +	125 029	1.7	376.4	14.9	150.6	26.8	-1.0	7.2	149.6	27.4
Total	**7 146 434**	**100.0**	**2 519.5**	**100.0**	**560.8**	**100.0**	**-14.0**	**100.0**	**546.8**	**100.0**
Grand total	**13 968 760**		**2 738.3**		**560.8**		**-14.0**		**546.8**	

1. Registered individuals with taxable income below the income-tax threshold

Source: National Treasury (2020b)

The problem is that the country has long faced the 'flight' by expats working abroad (Davis, 2019). They would rather leave the country in search of greener pastures than stay and 'fight', especially given the reports of corruption, a crumbling economy, the prevalence of crime, enforcement of Black Economic Empowerment (BEE), the unstable political climate and lack of economic opportunity in the country, to name a few (Business Tech, 2019a; Davis, 2019; My Broadband, 2019). Others were forced to find work abroad due to affirmative action or high unemployment in South Africa (Business Tech, 2020; Ramfol, 2019a; Oberholzer, 2008a). Expatriates already have a failing faith in the government and now find their tax morale dwindling due to another factor – increased taxes in the form of expat tax (Business Tech, 2019d; Du Preez and Stoman, 2019; New World Immigration, 2020; My Broadband, 2019; Oberholzer and Stack, 2014).

The National Treasury and SARS were forewarned of the possible consequences of imposing expat tax but still forged ahead. Before the promulgation of the section 10(1)(o)(ii) amendment, various stakeholders voiced their concerns about the amendment in Parliament (Seafarers Global, 2020; SAICA, 2017; Expatriate Tax Petition Group, 2020). They held that the implementation of expat tax will have a severely negative impact on the finances of expatriates and remittances to South Africa, including the issue of high living

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costs in foreign countries (National Treasury, 2017b). This forced the hand of many expats in an effort to shake the expat tax (Business Tech, 2019a).

When expats cease their tax residency, it leaves SARS with no claim on their foreign source income (Business Tech, 2019a). An expatriate who has worked abroad for a long period of time and who emigrated just before the implementation of expat tax on 1 March 2020 might be viewed with suspicion (Business Tech, 2019f). It seems as if the expats may then be regarded as having evaded expat tax, which means that SARS may see the ceasing of tax residency as crossing the line from avoidance to evasion.

3.3 ANALYSIS OF EXPAT ACTIONS AND TAX EVASION FACTORS

The two most influential factors causing tax evasion in South Africa are also driving factors behind expats' actions in response to the introduction of expat tax. The perception that expatriates have of the South African government was one of the main reasons causing more than 400,000 high-income earning professionals to leave the country (My Broadband, 2019). Another factor is the high tax rates in South Africa. The change from enjoying a full exemption on foreign remuneration income to being taxed on any foreign remuneration income above R1.25 million contributes to the sense of high tax rates in South Africa. The exit tax also contributes to this perception.

Petitions gathered by the Expatriate Tax Petition Group showed that the main concerns of expatriates, especially by those employed in the Middle East, were the financial impact of the heightened tax and poor employment opportunities in South Africa, implying poor governance (National Treasury, 2017b). This sentiment is shared by most South African residents (Business Tech, 2019d; Du Preez and Stoman, 2019; New World Immigration, 2020; My Broadband, 2019; Oberholzer and Stack, 2014). Du Preez and Stoman (2019) conducted a study where they analysed 12,000 tweets from Twitter over the 2017 Budget Speech period (from 14 February 2017 to 1 March 2017) to establish factors present that may predict a possible tax revolt in the country. The most significant factor identified was that of "failure of government" which includes failing public credibility and trust in government. Public's dissatisfaction with increased tax rates was also amongst the factors identified. Their study concluded that a tax revolt in South Africa is inevitable. It is important to note that these factors found present by Du Preez and Stoman (2019) were identified during the very Budget Speech in which expat tax was first mentioned.

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The actions taken by expats to sidestep expat tax are based on the two factors previously identified as being the most influential factors leading to tax evasion. Many other factors are also present. Bullock (2010) states that

> *…the integrity of the tax system is weakened when taxpayers with a high net worth are confident that they can underreport their income, overstate expenses or not report offshore income and get away with not paying what they are liable to pay.*

Schneider (2019) regards emigrating and ceasing one's tax residency to escape a corrupt government and high tax rates as a form of a tax revolt. A tax revolt in itself is tax evasion and will again increase the tax gap. Schneider (2019) predicts that it is highly likely that the current political and economic stance of South Africa could result in even lower tax morality and compliance in the country. Edward Kieswetter further confessed that tax evasion levels are rising (Smith, 2019). It may not be far-fetched to expect that many South African expats will follow in the footsteps of the initial evaders of tax in the country, as people tend to follow the masses (Fjeldstad and Semboja, 2001).

3.4 CONCLUSION

The two most influential tax evasion factors present in South Africa, namely the perceptions of government and high tax rates, were also present in the reactions or expected reactions, of expats to expat tax. Expat tax may be new to South Africa but tax evasion certainly is not. Tax evasion will continue to prevail and tax revenue will be under further strain should the expected evasion of the newly implemented expat tax in South Africa materialise – further increasing the tax gap.

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CHAPTER FOUR: CONCLUSION

4.1 INTRODUCTION

Tax evasion is not only a global phenomenon but has made its home in South Africa. Tax evasion will be found wherever tax is levied and will most likely be with us until the end of time (Venter, 2012; Slemrod, 2007). This study indicated that the newly imposed expat tax may indeed be a contributor to tax evasion in South Africa.

In this chapter, the results of the research study will be conveyed by indicating how each research objective was reached and by answering the research question. The knowledge gap that the study sought to fill will also be indicated. Recommendations for future research will be expressed, as well as a final remark on the study conducted.

4.2 RESEARCH OBJECTIVES REACHED

The research objectives that governed this study were each reached as stated below.

4.2.1 To understand the extent of expat tax

The definition of a "resident" as referred to in paragraph (a)(i) and (ii) of section 1 of the Act indicates that there are two tests in identifying whether an individual is a tax resident of South Africa, namely the ordinarily resident test and physical presence test. These two tests are mutually exclusive.

In South Africa, residents are taxed on a worldwide basis and non-residents on South African-sourced income only. This means that residents will be taxed in South Africa on any foreign remuneration income earned. The exemption available under section 10(1)(o)(ii) was discussed. As from 1 March 2020, the exemption has been capped at R1.25m. If the foreign remuneration income is not exempt in full, so-called 'expat tax' may arise. This section exempts the portion of foreign remuneration income relating to the number of days that the resident physically worked abroad, to a maximum of R1.25m. The section only applies to South African tax residents earning remuneration income by physically rendering services abroad under an employment contract. Furthermore, the resident has to physically work more than 183 calendar days in total (of which more than 60 days have to be continuous) during any 12-month period in the employer's employment abroad before this exemption can be used. The 12-month period has to start or end during

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the relevant year of assessment and need not coincide with a calendar month, calendar year or tax year.

Section 10(1)(o)(ii) only applies to South African tax residents. The expat may be a tax resident of South Africa and also of the other country based on the definition of resident in the relevant DTA. For this study where the UAE was chosen as a proxy country, Article 4(1)(b) of the DTA between South Africa and the UAE is relevant. If dual residency exists between two countries, the tie-breaker rules contained in DTA between South Africa and the other country will determine residency (Article 4(2) of the DTA between South Africa and the UAE; Article 4(2) of the OECD MTC)).

The general rule in Article 14(1) of the DTA between South Africa and the UAE (Article 15 of the OECD MTC) is that employment income earned may be taxed in both the residence and source state. The source state may, however, lose its taxing rights in certain instances (for example if the expat is present for 183 days or less in the source state).

If the tax residence country is determined to be South Africa under the tie-breaker clause, South Africa will tax the foreign remuneration income. Section 10(1)(o)(ii) exemption may then apply. In the instance where the excess remuneration above the R1.25 million exemption is taxable in South Africa and another country, relief from double tax can be obtained under either the relevant DTA (Article 22(1) of the DTA between South Africa and the UAE; Article 23 of the OECD MTC of 2017) or under the domestic law of the resident state. South Africa as the resident country provides relief from double taxation in the form of a rebate as set out in section 6*quat*(1) of the Act (SARS Interpretation Note 18 [issue 4]:6). Section 6*quat*(1) provides for a deduction of foreign taxes payable on foreign-sourced income against the South African tax levied on the same income. This section will however not apply to remuneration income earned in the UAE as they do not levy any income tax.

If the tax residence country is determined to be the UAE under the tie-breaker clause, it means that the expatriate has ceased South African tax residency and so-called ‘exit tax’ may then arise. Section 9H of the Act stipulates that a person is deemed to dispose of all of their worldwide assets (with certain exceptions) at market value on the day immediately preceding the day of cessation. This tax may impact on the decision of anyone who wishes to cease residency, especially high net-worth individuals.

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Both countries will have taxing rights in respect of foreign remuneration income but no tax liability will arise in South Africa as the foreign remuneration income is not from a South African source. The UAE levies no tax and therefore the expat will not pay any tax on the foreign remuneration income.

4.2.2 To identify the options available to affected expats in response to the imposed expat tax

Various options available to individuals in counteracting expat tax (as well as the considerations behind them) were identified, namely:

- Do nothing;
- Move back to South Africa;
- Set up a foreign entity;
- Financially emigrate;
- Cease South African tax residency (other than through financial emigration); or
- Other options.

It was also important to discuss the various ways in which an individual can attempt to fall outside the 'tax resident' scope, namely:

- ceasing to be ordinarily resident in South Africa by conveying an intention to become ordinarily resident in another country, with steps indicative of this intention having been carried out. Residency will cease on the day the individual no longer ordinarily resides in South Africa (SARS Interpretation Note 3 [issue 2]:5,7);
- if not ordinarily resident in South Africa at all during the relevant year of assessment, failing to meet all three requirements of the physical presence test. Residency will be ceased on the last day of the previous year of assessment (SARS Interpretation Note 4 [issue 5]:2,5);
- if not ordinarily resident in South Africa but meeting all the requirements of the physical presence test during a year of assessment, an individual ceases to be a resident once a continuous period of 330 days is spent abroad. Residency will end on the day of departure from South Africa (SARS Interpretation Note 4 [issue 5]:6); or

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- deemed to be exclusively a resident of another country under the tie-breaker clause of a DTA (definition of "resident" in Section 1 of the Act). Residency ceases on the day on which residency is deemed to be in another country (Par. 10 of the Commentary on Article 4 of the OECD MTC).

4.2.3 To define tax avoidance and tax evasion

Both tax avoidance and tax evasion were defined and compared. It was established that avoidance is legal, whereas evasion is illegal.

4.2.4 To identify the various factors causing tax evasion

Various factors causing tax evasion in South Africa identified in previous studies were briefly discussed. These factors were classified under psychological, economic and sociological factors. The two most influential factors to tax evasion in South Africa as identified by other studies, namely the perceptions of government and high tax rates, were discussed in more detail.

4.2.5 To understand the extent of tax evasion in South Africa

The extent of tax evasion in South Africa was thoroughly discussed; with the tax gap being the biggest indicator of the extent of tax evasion in the country. The effects of the two factors that were found to be the most influential regarding tax evasion in South Africa were discussed in detail. The possibility of a tax revolt emerging because of these two factors was illuminated.

4.2.6 To compare the factors giving rise to the various options available to affected South African expats

The two most influential factors causing tax evasion in South Africa were compared to the options available to South African expats in response to expat tax. The analysis and comparison aimed to determine whether these factors can be said to be a driving force behind the options selected by expats to respond to the introduction of expat tax. The probability of a looming tax revolt in this regard was also discussed.

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4.2.7 To conclude whether these available options can be regarded as evasion and therefore contribute to tax evasion in South Africa

After the two factors were applied and the possibilities of a looming tax revolt in the country regarding expat tax were discussed, it was determined that expat tax is expected to contribute to tax evasion in South Africa – furthering the tax gap. This answered the research question.

4.3 THE RESEARCH QUESTION ANSWERED

The study's research question was set as "Will the newly imposed expat tax contribute to tax evasion by South Africans working abroad?" This question was answered by reaching each of the set research objectives. The concluding result of the study is that expatriates are indeed expected to endeavour to evade the newly imposed expat tax.

The two most influential factors that cause tax evasion in South Africa were identified as individuals' perspective of government and high tax rates. These factors were also present when assessing the reactions and expected reactions of expatriates to expat tax.

SARS commissioner, Edward Kieswetter, confessed that tax evasion in the country is on the rise (Smith, 2019). This was substantiated by Schneider's (2019) prediction that the current political and economic stance of South Africa will very likely result in lower tax morality and compliance in future. Expatriates are expected to follow the example of these tax evaders – making them just another sheep in the flock.

4.4 KNOWLEDGE GAP

The knowledge gap was identified as a lack of academic articles regarding expat tax in South Africa, as it is such a new concept. The study addressed this gap by conducting an overview of expat tax. The study further explored the link between expat tax and tax evasion in South Africa.

The findings of this study can be used by SARS to effectively implement expat tax and combat the expected evasion thereof. Strategies and policies may now be implemented to effectively contain tax evasion and strengthen tax compliance. Smith (1921) professed that the success of government and economic growth in a country relies on the truthfulness of its citizens.

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The findings might impress upon the government the importance of proper governance and prudent spending of tax revenue collected from citizens. This will, in turn, ensure more compliant taxpayers and a willingness to contribute to the country's funds.

4.5 FUTURE RESEARCH

Future research can be conducted on various solutions to, or remedies against, the expected evasion of expat tax identified in this study. The extent of this evasion can be studied and perhaps quantified. This study can also be furthered by evaluating how cost-effective various solutions to South Africa's tax evasion epidemic can be. This will, in turn, result in increased tax revenue collection by the government and decrease the tax gap. Ways to better government spending and service delivery may even lead to a more tax compliant country and increased economic growth.

4.6 FINAL REMARK

By implementing strategies to encourage and strengthen tax compliance amongst expatriates, as well as effectively implementing expat tax and containing the evasion thereof, South Africa may narrow the tax gap.

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