DEFEATING SECTION 10(1)(o)(ii) OF THE INCOME TAX ACT WITHIN THE PARAMETERS OF SOUTH AFRICA'S GENERAL ANTI-AVOIDANCE RULES

by

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ABSTRACT

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Background: The foreign remuneration exemption contained in Section 10(1)(o)(ii) of the Act was capped at R1.25 million with effect from 1 March 2020. This amendment gave rise to so-called expat tax, namely South African expats being subject to tax in South Africa on foreign remuneration income exceeding R1.25 million. The amendment to the legislation came in response to the situations of double non-taxation created by its predecessor which allowed for a full exemption of foreign remuneration earned by South African expats working abroad. In particular, expats rendering employment services in host countries imposed little or no taxation on the respective employment income, such as the UAE, meaning that tax leakage was rife. The response to the amended Section 10(1)(o)(ii) of the Act has resulted in a mass exodus of expats who are choosing to cease tax residency in South Africa through the application of a DTA tie-breaker clause, deeming them exclusively tax resident in the other country for purposes of the DTA. South African expat tax is avoided as sole taxing rights of remuneration income is usually awarded to the source country. The act of ceasing tax residency through the operation of the permanent home criterion of a DTA tie-breaker clause against the backdrop of the South African GAAR provides the basis of analysis in this study.

Main purpose of study: The study undertook to analyse whether the Section 80A–80L of the GAAR could be triggered by South African expats seeking to cease tax residency in South Africa through application of Article 4(2) of the SA/UAE DTA. The studied focused on the first criterion of the DTA tie-breaker clause, namely, the 'permanent home'. This criterion was analysed and applied to practical scenarios common to South African expats in a quest to determine whether the GAAR's application is warranted.

Method: A doctrinal approach was followed in the study which entailed sourcing information on Section 10(1)(o)(ii) of the Act from international instruments such as the OECD MTC 2017 and its Commentary, the South African GAAR, domestic and international case law, text books, journal articles, webinars, video recordings of lectures, and consultations with tax experts. Once sourced and analysed, the information contained in these sources was transposed and applied to the set of facts under consideration for the study to have practical effect.

Results: The study found that a variety of factors contribute to the mass exodus of taxpayers leaving South African shores for greener pastures. These factors may be indicative of a *legal* tax revolt since the study found that breaking of tax residency by invoking the permanent home criterion of the tie-breaker test did not fall foul of the South African GAAR. The capping of the Section 10(1)(o)(ii) exemption incentivises expats to break their tax residency and so escape application of the exemption to the expat's foreign remuneration income. However, when residency is broken an exit charge is triggered on the expat's worldwide asset base (except those remaining in the capital gains tax net such as immovable property in South Africa), since SARS claims that it would have received this capital gains tax if the expat had sold the assets whilst being ordinarily tax resident in South Africa. Dual resident expats who seek to cease tax residency in South Africa bear the burden of proving that their permanent home for purposes of the DTA tie breaker is in the other Contracting State and not in South Africa. The study illustrates that since South African domestic law provides for the breaking of residency by invoking the DTA tie-breaker clause and therefore the disapplication of Section 10(1)(o)(ii) of the Act, and since numerous expats are choosing to invoke the DTA tie-breaker clause to cease tax residency, that the actions taken in this regard are normal, they do not meet any of the tainted elements contained in the South African GAAR and cannot be classified as impermissible avoidance arrangements.

Conclusions: South African expats who notify the Commissioner of the intention to apply the DTA tie-breaker clause contained in Article 4(2)(a) of the SA/UAE DTA and therefore cease tax residency in South Africa will not trigger application of the South African GAAR, since none of the tainted elements housed in Section 80A(b)–(c) of the Act are met.

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Table 1: Abbreviations and acronyms used in this document

Abbreviation	Meaning
DTA	Double Taxation Agreement/Treaty
COVID-19	Coronavirus SARS-CoV2
GAAR	General Anti-Avoidance Rules
MTC	Model Tax Convention
OECD	Organisation for Economic Cooperation and Development
SARS	South African Revenue Service
SARB	South African Reserve Bank
SAAR	Statutory anti-avoidance rules
UAE	United Arab Emirates
TLAA	Taxation Laws Amendment Act 23 of 2020
TLAB	Taxation Laws Amendment Bill
TAA	Tax Administration Act No. 28 of 2011
The Act	Income Tax Act No. 58 of 1962 (as amended)
Expat	An individual living and/or working in a country other than their country of residence
CGT	Capital Gains Tax
Expat tax	Section 10(1)(o)(ii) of the Act which refers to the tax to be paid by South African tax residents on foreign remuneration earned abroad.
The Constitution	The Constitution of the Republic of South Africa Act, 108 of 1996

CHAPTER 1: INTRODUCTION

1.1. INTRODUCTION

The exemption contained under Section 10(1)(o)(ii) of the Act came into effect in 2000 in an effort to prevent double taxation of a natural person's income in South Africa and in a host country (SARS Interpretation Note 16, 2021:1). However, for years of assessment starting on or after 1 March 2020, the exemption afforded in Section 10(1)(o)(ii) has been capped at R1.25 million. Therefore, foreign remuneration earned by South African residents outside of the Republic will no longer be fully exempt (SARS Interpretation Note 16, 2021:1).

According to a joint publication of the National Treasury and SARS, the tax assessed as a percentage of taxable income in the 2019 tax year was 22.5%, an increase of 0.9% from the 2018 tax year of 21.6% (SARS and the National Treasury Tax Statistics, 2020:40). According to the joint publication, this is attributable to the increase in the top marginal tax rate from 41% to 45%. Interestingly, capital gains tax on deemed disposals arising due to individuals ceasing their tax residency status in South Africa is also cited as a contributing factor to the increase in taxable income (SARS and the National Treasury Tax Statistics, 2020:40). It remains to be seen whether the total capital gains tax collected (Section 9H of the Act imposes an exit charge on all assets of a taxpayer upon ceasing of residency) as a result of individuals breaking tax residency will compensate for or outweigh the loss of future tax revenue on foreign remuneration income exceeding R1.25m which South African expats earn after having ceased to be a South African tax resident. The irony is that the Section 10(1)(o)(ii) amendment sought to increase tax revenue. Instead, it is encouraging South Africans to emigrate (Geldenhuys, 2019). The impact of the amendment is that an increase in South African expats seeking to break their tax residency in South Africa has been observed, which could be indicative of a tax revolt taking place (Bloomberg, 2021; Du Preez and Stoman, 2020:477).

A study analysing tax revolt factors present in South Africa and predicting the possibility of a tax revolt was conducted from 14 February 2017 to 1 March 2017 through the collection of Twitter feeds (12,000 tweets sent by South Africans) pertaining to the national budget speech (Du Preez and Stoman, 2020:455). These tweets by South Africans were collected from the period before and after the South African National Budget Speech which was held on 22 February 2017 (Du Preez and Stoman, 2020:465). During the National Budget Speech an overwhelming number of tweets were collected relating to failure of the government, indicating declining credibility, trust and confidence in the government, with hashtags such as #ANCGuptaFaction and #StateCaptureReport (referring to the damning report released by the Public Protector, Thuli Madonsela in 2016), and #TheCapturedOnes (Du Preez and Stoman, 2020:468-470). A month later, the acting Finance Minister, Pravin Gordhan, was dismissed by former President Jacob Zuma which unsettled local and international investors and exacerbated claims of corruption (Chutel, 2017).

A tax revolt involves action against a tax or tax system and South Africa has seen more and more of these movements tending to a possible tax revolt in recent years, such as the refusal of countless individuals to pay for electronic tolls in 2013 and the #FeesMustFall movement demanding free education for tertiary level students in 2016 (Du Preez and Stoman, 2020:457). The study conducted by Du Preez and Stoman (2020:466-477) found eight revolt factors to be present in South Africa which were indicative of a tax revolt.

Figure 1: The eight factors present in South Africa between the period 14 February 2017 and 1 March 2017 related to the National Budget Speech on 22 February 2017.

Table V. Factors found to be present in South Africa

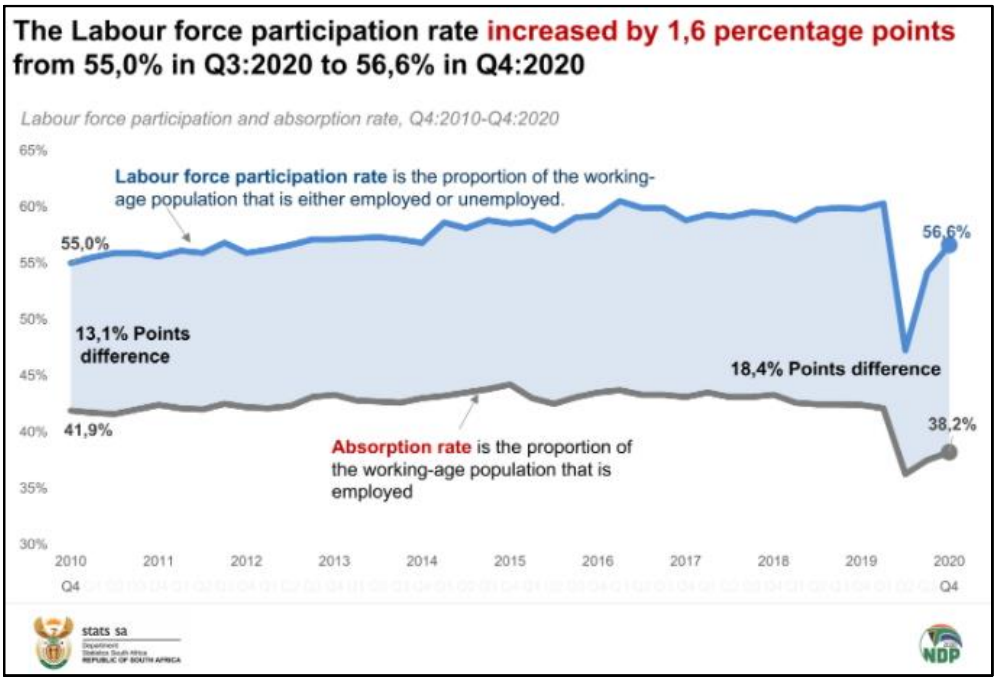
Factor no.	Factor descriptor
F1	Failure of government to address the imminent collapse
F2	Significant number of people with substantial debt
F3	Onerous tax systems, including many different types of tax
F4	High number of unemployed people
F5	Education frustration
F6	Increase in tax rates on citizens already overburdened by current taxes
F7	Poor quality of governors and performance of the country's leaders and administration
F8	Wastefulness

Source: Du Preez and Stoman, 2020:466

A tax revolt could erupt in the form of a mass exit of taxpayers out of South Africa (Du Preez and Stoman, 2020:477). Factors 2, 3, 4 and 6 mentioned in Figure 1 above are particularly relevant to the study for the following reasons:

- Factors 2 and 4: The COVID-19 global pandemic which began in 2020 has not only weakened economic growth in South Africa but has also degraded an already structurally weak labour market in the country. In Quarter 4 of 2020, South Africa recorded the highest unemployment rate of 32.5% since 2008, with an absorption rate (employment-to-population ratio) at 38.2% as shown in Figure 2 (Statistics South Africa, 2021; The World Bank, 2021). Household debt increased at a faster pace in Quarter 4 of 2020 and accounted for 47.6% of the country's nominal GDP in December 2020 (The South African Reserve Bank, 2021; CEIC, 2020).

Figure 2: Statistics South Africa, 2021



- Factor 3: Section 10(1)(o)(ii) of the Act places an *additional* tax liability on South African expats which did not exist prior to 1 March 2020, as foreign employment income earned before this date was exempt from South African tax.
- Factor 6: High net worth South African expats are now required to pay tax of up to 45% on their foreign employment income exceeding R1.25 million. There may also be capital gains tax due in the year of assessment in which tax residency is ceased.

These factors are still present in South Africa and have been historically relevant in the risk associated with a tax revolt in South Africa (Du Preez and Stoman, 2020). As early as September 2017, the FNB House Price Index of September 2017 cited that for the first time since 2010, 7.5% of home sellers in South Africa stated that the reason for selling their houses was due to emigration (Peter, 2019). The latest FNB Property Barometer of July 2021 also indicates that emigration transactions account for 7% of transactions, whilst downgrading due to financial pressure accounts for a whopping 21% of transactions (FNB, 2021).

Taxpayers who emigrate from South Africa as part of a tax revolt, will only escape the South African tax when a break in tax residency takes place. This may lead to a liability for capital gains tax, otherwise known as an 'exit charge', which is designed to compensate the fiscus for the loss of future tax revenue (Olivier and Honiball, 2011). In essence, the ceasing of South African tax residency needs to consist of a 'clean break' whereby a taxpayer no longer exhibits a strong intention to be resident in the country and fails to comply with the requirements set out in the ordinary residency test and the physical presence test (SARS Interpretation note 3 [Issue 2]:2). There is, however, one more way to break tax residency, and this is through the application of a DTA tie-breaker clause of a relevant DTA. The cessation of a natural person's tax residency status through the application of a DTA as an action taken by South African expats is at the heart of this study.

'Expat tax' refers to the tax burden South African expats face after the foreign remuneration exemption was capped to a maximum of R1.25 million as from 1 March 2020. Expats can cease tax residency in South Africa by relying on the application of a DTA which may deem a natural person to be *exclusively resident* of another country, despite still being ordinarily resident in the Republic (SARS Interpretation note 3 [issue 2]:2,8; Van Zyl, 2020). A South African expat who once enjoyed the full tax exemption afforded on foreign-earned income might qualify as a dual resident according to domestic South African law and the laws of the host country where the expat is rendering employment services.

The OECD Model Tax Convention is a model treaty for countries concluding bilateral tax conventions and plays an important role in the international tax arena, since it forms the basis of economic alliance amongst countries engaged in cross-border trade (Olivier and Honiball, 2011). Article 4(2) of the OECD MTC is applicable in instances where a natural person is considered resident for tax purposes in both Contracting States to a DTA. This article ensures that each taxpayer is deemed a tax resident in only one country of the two countries at a time (Van Zyl, 2020). The OECD serves as the basis for the network of DTAs concluded by South Africa and other countries, and its commentary has been accepted by South African courts in the interpretation of DTAs (*Secretary for Inland Revenue v Downing 1975 (4) SA 518 (A) at 527)*. Whilst South Africa is not a member of the OECD, it *does* possess observer status. The first and highest criterion in the hierarchy for determining residency is contained in Article 4(2)(a) of the OECD Model Tax Convention and relates to identification of the country where the individual's permanent home is situated. This may serve as a strong indication of tax residency.

A South African expat who remains ordinarily resident in South Africa while earning foreign remuneration income in excess of R1,25 million for the particular year of assessment, will be subject to normal tax on the excess in South Africa, as well as potentially in the host country in which the expat exercises his or her employment services. The amendment of Section 10(1)(o)(ii) taking effect from 1 March 2020, has the controversial effect of ensuring that the South African ordinary resident expat is taxed twice on income exceeding R1.25 million earned abroad, provided that the host country where the individual is rendering services levies tax on the same income (Olaogun and de Risi, 2019:16). Relief is available to the South African expat (who remains a tax resident of South Africa) in the form of Section 6*quat,* a unilateral tax credit or rebate in respect of foreign taxes payable on income received by or accrued to residents from sources outside South Africa, which is granted in substitution of DTA relief (Section 6*quat* of the Act). However, the total rebate is limited to the South African normal tax payable in respect of the amount included in the resident's taxable income. It only provides a credit against *actual* South African tax payable to the maximum of the tax levied in South Africa on that income (Section *6quat*(1B) of the Act states that the amount of the foreign tax credit is limited to the extent of South African tax liability of the resident with respect to the foreign source income in aggregate).

The introduction of expat tax was an especially big blow for taxpayers working in low or no tax jurisdictions, such as the UAE. Previously South African expats were taxed neither in the no tax host country nor in South Africa. However, a South African tax resident *deemed* to be a non-resident in South Africa by way of a DTA tie-breaker clause will still be in a situation of double non-taxation where the employment country levies no tax.

Many expats are, in response to the amendment, arranging their affairs to ensure that they are deemed non-residents in South Africa under the relevant DTA tie-breaker clause. Whilst it is acceptable for taxpayers to arrange their tax affairs in a manner that is tax efficient to them, the *manner* in which the taxpayer goes about arranging this may amount to impermissible tax avoidance in terms of Section 80A of the Act. Provided a taxpayer can prove, on a balance of probability, that one of the requirements of the South African GAAR is not present, the application of the South African GAAR will not apply. Application of the GAAR may force the taxpayer to pay the taxes that should have been paid, thus incurring South African tax liability on the excess foreign remuneration income above R1,25 million (Section 80B of the Act).

1.2. RATIONALE FOR THE STUDY

Since 2001 South Africa has applied the residence basis of taxation, meaning that persons considered resident in the Republic are taxed here on their worldwide income (Olivier and Honiball, 2011:849). Therefore, the connecting factor between the taxation of the income and the Republic is the resident person who receives the income or has accrued it (Olivier and Honiball, 2011:19). The Section 10(1)(o)(ii) exemption was introduced in 2000 in a quest to prevent double taxation of a South African individual's income between South Africa and a host country (SARS Interpretation Note 16, 2021).

Initially, Section 10(1)(o)(ii) allowed for a full exemption of all foreign employment income earned by a South African resident individual. It became evident however, that situations of double non-taxation arose where the host country imposed little or no tax on the respective employment income (SARS Interpretation Note 16, 2021). An example of such a country is the UAE.

In response to this 'excessively generous' exemption, the South African National Treasury proposed in the 2017 budget review that the Section 10(1)(o)(ii) exemption be adjusted so that foreign employment income will only be exempt from tax if it is subject to tax in the host country (National Treasury, 2017:138). On 19 July 2017, the draft Taxation Laws Amendment Bill was released repealing the full exemption provided for in Section 10(1)(o)(ii) (Draft Taxation Laws Amendment Bill, 2017). Public outcry against the sudden repeal of Section 10(1)(o)(ii) resulted in the implementation of a maximum exemption of R1 million per year of assessment to take effect from 1 March 2020 (Lamprecht, 2018).

The government took notice of the large increase in South Africans ceasing residency in an effort to avoid the change in legislation which imposed the cap on Section 10(1)(o)(ii) and increased the cap to R1.25 million effective 1 March 2020 (Fin 24, 2020). In order to qualify for the exemption, the South African tax resident must be physically outside the Republic for at least 183 full days during any 12-month period starting or ending during the relevant year of assessment, of which at least 60 full days need to be continuous (SARS Interpretation Note 16, 2021). Due to the travel bans during the COVID 19 global pandemic, the Tax Laws Amendment Act 2020 relaxed the days requirement in respect of the 2020 and 2021 years of assessment from 183 days in aggregate to 117 days. However, the 60 consecutive days were not decreased (SARS Interpretation Note 16, 2021).

Whilst the amount of R1.25 million may seem generous, the remuneration eligible for the application of this exemption is broad, including fringe benefits such as housing, education, security and home leave flights (Oostingh, 2019). In addition, South African tax residents will also be subject to tax on benefits which are unique to an assignment in the host country, where the rules of the host country may not regard those so-called 'benefits' as taxable benefits (Da Silva, 2020). Assignment specific allowances or benefits differ according to industry and country. For example, it might be that due to poor infrastructure and political instability an employee requires security in the performance of his/her employment duties.

Since the amendment to Section 10(1)(o)(ii), expats face expat tax and additional tax compliance costs which were once not anticipated. Coupled with the inclusion of host country benefits in the expatriate's normal tax in South Africa (despite certain host country's tax rules excluding these benefits as taxable benefits) and the high costs of living abroad in certain countries, taxpayers were outraged (Da Silva, 2020; Duvenhage, 2019).

According to Du Toit (2019), the taxpayers who leave South African shores are relied on heavily by SARS for their high earning capacity and it is these payers who bear most of the tax burden through personal income taxes. The prevalence of corruption, the state of the country's economic outlook, and the unstable political climate are all factors which contribute to many South Africans leaving and seeking employment opportunities abroad (Du Toit, 2019:2). The amendment of Section 10(1)(o)(ii) of the Act has "forced the hand" of many expats who see the ceasing of tax residency in South Africa as the only viable option for the avoidance of expat tax (Du Toit, 2019). The disdain and wilful behaviour of expats to avoid the ramifications of tax residency in South Africa may equate to a tax revolt, where taxpayers do not share the same view as the government on how taxpayer money is to be spent (Du Toit, 2019).

Since South Africa applies a residence-based tax regime as defined in Paragraph (i) of the "gross income" definition contained in Section 1 of the Act, the applicability of Section 10(1)(o)(ii) of the Act would fail if residency is broken. One mechanism for breaking residency is through the application of a tie-breaker treaty clause which would deem an individual exclusively resident of another Contracting State by virtue of the double taxation agreement (hereafter the DTA) (Article 4(2) of OECD MTC).

Double non-taxation may result due to the application of a DTA's tie-breaker clause having a negative impact on the South African tax base (Du Toit, 2019:2). It is therefore critical to assess whether this tax benefit encompasses impermissible tax avoidance and whether it would trigger the application of South Africa's GAAR.

1.3. RESEARCH PROBLEM

The joint publication of the National Treasury and SARS entitled '2020 Tax Statistics' highlights how in the 2019/20 fiscal year, personal income tax was the main contributor of the R1,355.8 billion revenue collected amounting to 39% of this amount (SARS and the National Treasury Tax Statistics, 2020). In addition, for the 2019 tax year, 6.3 million individual taxpayers were expected to submit tax returns, however, only 4.3 million were assessed taxpayers and of these 4.3 million individuals, 1.1 million earned taxable income in excess of R500 000 (SARS and the National Treasury Tax Statistics, 2020). These statistics reveal how dependent South Africa is on a small taxpayer base to generate tax revenues. Notably, between 2016 and 2019 the capital gains tax on financial emigration was a contributing factor to the increase in taxable income (SARS and the National Treasury Tax Statistics, 2020).

South African resident taxpayers rendering services outside the Republic and earning certain types of remuneration for employment services qualify for the R1,25 million exemption under Section 10(1)(o)(ii) of the Act, provided all requirements of the exemption are met (SARS Interpretation Note 16, 2020). This mini-dissertation seeks to address whether certain actions taken by a South African resident taxpayer earning in excess of R1,25 million foreign remuneration to circumvent the application of Section 10(1)(o)(ii) will trigger anti-avoidance provisions in terms of the South African GAAR. This mini-dissertation will highlight actions typically taken by individuals in a quest to escape South African tax liability distinguishing between three categories, namely: tax evasion, 'impermissible' tax avoidance, and legitimate tax mitigation (Prebble and Prebble, 2010; SARS, 2005:2).

To date, the use of treaty tie-breaker rules to cease tax residency in South Africa and prevent the application of Section 10(1)(o)(ii) of the Act has not been analysed nor studied in relation to South Africa's GAAR. After all, tax emigration directly threatens the tax base of South Africa, which is the very object that the GAAR seeks to protect (Pidduck, 2017:33). The relationship between the so-called South African 'expat tax' and the country's GAAR is fertile ground for research since the amendment to Section 10(1)(o)(ii) came into effect on 1 March 2020.

1.3.1. Scope of the study

In order to ensure that this study has practical application, a fictitious South African individual by the name of Lucy will be used as proxy. For purposes of this chapter, Lucy is employed by a foreign employer in Dubai and earns a salary to the equivalent of more than R1.25 million per annum. Lucy visits South Africa once a year for one month at a time. Although she is living and working in the UAE, Lucy is still ordinarily resident in South Africa and therefore taxed on a worldwide basis in South Africa. The only assets owned by Lucy in South Africa, are cash, her (and her husband Jamie's) previous primary residence in Pretoria and some personal use assets. She meets all of the requirements of the Section 10(1)(o)(ii) exemption. Lucy is also in possession of a tax residency certificate issued by the UAE Ministry of Finance, indicating that she is a tax resident of the UAE.

The large South African expat community in the UAE is estimated to be between 60,000 and 80,000 people (South African Embassy Abu Dhabi, UAE). In 2021 the total population of the UAE is estimated at 9.9 million with an expat population taking up 88.52% of the total population (UN World Population Dashboard, 2021; GMI, 2021). The large South African expat community present in the UAE was a strong indicator that the UAE, as a host country in this study's analysis, should be used due to its practical benefit. In addition, the UAE was selected due to the fact that the UAE levies no income tax on individuals and therefore, a South African expatriate earning UAE source income for employment services rendered in excess of R1,25 million would be affected by the amended Section 10(1)(o)(ii) exemption and would want to steer clear of its application. Prior to the amendment of Section 10(1)(o)(ii), South African expats working in the UAE were effectively tax exempt in both the UAE and South Africa, resulting in a situation of double non-taxation.

Furthermore, South Africa's DTA with the UAE specifically provides that in the event that an individual is a resident of both contracting states (for example where the resident remains ordinarily resident in South Africa) then the individual's residency status shall be determined through application of Article 4(2) and residency will be ceased in one of the contracting states by way of application of the DTA (South Africa – United Arab Emirates Income Tax Treaty, 2017; PricewaterhouseCoopers, 2021; Kamdar, 2019). This is in line with the OECD's MTC, on which the South Africa – UAE DTA is largely based.

Additionally, the following limitations apply to the study:

- Natural persons are the focus group of the study and not juridical persons.
- Natural persons who earn business profits or who are working for a South African employer are not considered for purposes of this study.
- Lucy's only immovable asset is the house which she and her husband Jamie own in Pretoria, South Africa. This will not trigger capital gains tax, otherwise known as the 'exit charge', when Lucy ceases residency, therefore the 'exit charge' stipulated in Section 9H of the Act will not be discussed in detail and it must be assumed that this will not play a role in Lucy's decision to break tax residency in South Africa.
- Tax jurisdictions that levy tax on services rendered in that country, will not be considered for purposes of this study.
- The physical presence test will not be discussed in detail; however, it will be mentioned for purposes of understanding the South African concept of 'residency'.
- The requirements of Section 10(1)(o)(ii) of the Act are not discussed in detail since the study follows from the presumption that the South African expat qualifies for the exemption.
- In order to limit the scope of the study, only Article 4(2)(a) of the SA/UAE DTA relating to the 'permanent home' criterion will be briefly discussed, and not the centre of vital interest and the other criteria pertaining to the tie-breaker clause.

- In the context of the South African GAAR contained in Section 80A–80L of the Act, the focus of the study is placed on impermissible avoidance arrangements entered into or carried out in a non-business context as provided in Section 80A(b) of the Act. A comparative analysis of Section 103(1) of the Act (i.e. the 'old' GAAR) and Section 80A-80L of the Act (i.e. the 'new' GAAR) will not be discussed.

1.4. RESEARCH QUESTION

This study is targeted at South African taxpayers working abroad (i.e. expats) and assisting them with the structuring and planning of their South African tax affairs within the legal parameters provided in the Act. In order to achieve this, the study seeks to answer the following research question:

Would the application of treaty tie-breaker rules by South African residents to defeat Section 10(1)(o)(ii) trigger the South African GAAR?

1.5. RESEARCH OBJECTIVES

With this in mind, there are two overarching questions that this mini-dissertation seeks to understand and solve:

- Would the GAAR be relevant to certain actions taken by residents to cease tax residency? and
- How can residents break tax residency within the parameters of the GAAR?

The research objectives identified in pursuance of answering the questions above are as follows:

- To understand, describe and identify the principles relating to ordinary resident, the Section 10(1)(o)(ii) exemption, as well as the DTA tie-breaker clause relating to 'permanent home'.
- To understand, describe and identify the principles encompassed in the South African GAAR and its application;

- To understand actions taken by South African tax residents to cease residency and so defeat the capping of Section 10(1)(o)(ii) in South Africa, specifically the first criterion of the 'permanent home';
- To apply the South African GAAR in instances where South African expats have taken actions to cease residency under the DTA; and
- To suggest remedies for South African residents to prevent the application of the South African GAAR.

1.6. RESEARCH DESIGN AND METHODOLOGY

The research design and methods to be used in this study are discussed below.

1.6.1. Doctrinal legal research

A doctrinal legal research methodology (or otherwise known as the 'black-letter law' approach) will be applied. First the legal rules governing the taxation of foreign employment income, the DTA permanent home tie-breaker rule and the rules pertaining to GAAR will be analysed and discussed. The legal provisions, judicial decisions and commentary will be analysed and organised in relation to one other. A qualitative approach is adopted as the data is documentary and not empirical in nature (Hutchinson and Duncan, 2012:110-116; McKerchar, 2008:15).

1.6.2. Data collection and analysis

The main sources of literature for this study consist of literature (books, journal articles, internet articles, governmental entity publications, dissertations and writings of scholars), video recordings, domestic and foreign case law, and advice from experts prominent in the field of taxation on the concept of 'residency' in a South African domestic tax context and DTA context, the Section 10(1)(o)(ii) partial exemption afforded in the Act and its effects on expats, the South African GAAR and actions by expats which might trigger the GAAR. Application of the relevant legal rules pertaining to the tax consequences of income earned outside the Republic such as Section 1(1), 10(1)(o)(ii), and Section 80A–80L of the Act as well as the SA/UAE DTA, and the OECD MTC Commentary will be applied to a set of facts under consideration, with the aim of discovering and developing legal doctrines which seek to clarify when certain actions taken by expats will trigger the GAAR (Chynoweth, 2008:29-30). This study will adopt an analytic research process, instead of data collection, and will present the findings qualitatively (Hutchinson and Duncan, 2012:100).

The research conducted involved a process of gathering, understanding, summarising and applying the information and knowledge obtained from the data sources listed above to a fictional set of facts for purposes of shedding light on the realities faced by a South African expat in a dual residency dilemma. The consultation with Hugo van Zyl, an emigration and tax expert, via Google Meet, enhanced the understanding of the literature collected for the study and gave it added practical effect (Van Zyl, 2021). The fictitious scenario identified in the study was born from the consultation with Mr. van Zyl as well as recent literature published on the topic of expat tax. This scenario was then tested against the South African GAAR in order to achieve the research question which this study aims to answer, namely, would the application of treaty tie-breaker rules by South African residents to defeat Section 10(1)(o)(ii) trigger the South African GAAR?

1.7. STRUCTURE OF THE MINI-DISSERTATION

1.7.1. Chapter 1 - Introduction

The research question and the research objectives are set out indicating to the reader that a knowledge gap exists with regard to the relationship between certain actions taken by South African expats to avoid application of the Section 10(1)(o)(ii) exemption and whether these actions taken amount to impermissible tax avoidance. The research methodology used to conduct the study is also disclosed, the basis for the selection of the case law, and identification of the subjects whom this study is aiming to assist.

1.7.2. Chapter 2 - Ordinarily resident, Section 10(1)(o)(ii) and DTAs

This chapter will identify, define and discuss important concepts relating to tax 'residency' in South Africa and its meaning in a DTA. The definition of 'ordinarily resident' in a South African domestic tax law context will be explored, as well as 'residency' in terms of a DTA.

The treaty tie-breaker clauses, the 'permanent home' criterion, will be the focal point of the chapter.

1.7.3. Chapter 3 - South Africa's general anti-avoidance rules

This chapter will outline and describe the role of the South African GAAR and its roots in an international context in relation to impermissible tax avoidance schemes. The definition of key terms contained in Section 80A of the Act will be discussed, as well as a breakdown of each element contained in Section 80A(b) and (c).

1.7.4. Chapter 4 - The 'permanent home' treaty tie-breaker criterion and the South African GAAR in practice

In this chapter, the most common and practical scenarios experienced by South African expats will be highlighted and tested against the relevant requirements of the South African GAAR. In particular, this mini-dissertation will analyse the instance where South African expats maintain a permanent home in South Africa but render employment services abroad and rent out their home in South Africa.

1.7.5. Chapter 5 – Conclusion and recommendations

The final chapter will answer the research question and research objectives. Recommendations for future research and the contribution of the research will be detailed whilst also recognising the limitations posed in the study.

CHAPTER 2: ORDINARILY RESIDENT, SECTION 10(1)(o)(ii) AND DTAs

2.1. INTRODUCTION

South African tax resident natural persons are taxed on a worldwide basis. Therefore, if a South African resident renders services abroad, the remuneration income is taxable in South Africa. Provided that certain requirements are met, the foreign remuneration income exemption contained in Section 10(1)(o)(ii) of the Act will exempt the first R1.25 million. In this chapter the meaning of ordinarily resident will be analysed in detail. Thereafter, the requirements of Section 10(1)(o)(ii) will briefly be explored. Lastly, the DTA tie-breaker clause will be analysed, with specific reference to the meaning of permanent home.

2.2. RESIDENCY

2.2.1. The concept of residency in South Africa

At its core, the application of this exemption is causally connected to the taxpayer's residency status in South Africa, since residents are taxed on a worldwide basis and non-residents are only subject to tax in South Africa on income earned from sources in South Africa (SARS Frequently Asked Questions [FAQ], 2020:2). In *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* 14 SATC 1, Watermeyer CJ held that one possible meaning of the word 'source' is 'the originating cause of the receipt of the money' and this originating cause is the 'work' that the taxpayer does to earn the income (*Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd 14 SATC 1:8-9*). Therefore, in terms of this case, the 'source' of income involves a two-pronged test:

1. What activity/originating cause gave rise to the income; and
2. In which country were the activities which gave rise to the generated income (Olivier and Honiball, 2011:12).

The Supreme Court of Appeal in *Rhodesia Metals Ltd (In Liquidation) v COT* 1938, AD 282 at 300 held that source is not a legal concept, rather it is what a practical man would regard as the real source of the income concerned, and that ascertaining the source of income is a practical and factual question. As the source of remuneration is where the services are rendered, non-residents will not be taxed in South Africa on remuneration earned for services rendered outside the Republic. The capping of the exemption at R1.25 million came in response to the unintended double non-taxation previously created by the uncapped exemption in instances where territories impose little or no tax on remuneration income (SARS Interpretation Note 16, 2021; SARS Frequently Asked Questions [FAQ], 2020:2).

As the exemption is now capped at R1.25 million per annum, it means that amounts in excess of this will be subject to normal tax, regardless of whether such income was taxed in the source country (SARS Interpretation Note 16, 2021:1). In the case of double taxation, DTA provisions, specifically the elimination of double taxation clauses such as Article 10 and 11 of a DTA, or domestic law, in the form of the Section 6*quat* credit, may provide relief to South African resident taxpayers. However, it is possible for an individual to escape South African tax liability altogether if he or she becomes exclusively tax resident in another country and thereby ceases residency in South Africa (Olivier and Honiball, 2011:32). By ceasing tax residency, through the application of a tie-breaker provision in a DTA, and therefore becoming *exclusively* resident in another country, the application of Section 10(1)(o)(ii) is defeated entirely (Saggers, 2019:50; SARS Interpretation Note 3 [issue 2], 2018:8).

In deciding whether a country is allocated the taxing rights over certain income, a 'nexus' or 'connecting factor' should exist between the income and a country (Olivier and Honiball, 2011:9). This nexus between the income generated and a particular country wherein the income is generated is defined according to the domestic law of different countries, as either the link between the income receiver and the country, or the income activity and the country (Olivier and Honiball, 2011:9). 'Gross income', as defined in Section 1 of the Act, draws an important distinction between residents and non-residents for the purposes of levying tax in South Africa. In the case of any non-resident, the definition of gross income requires that the total amount, in cash or otherwise, which is received by or has accrued to or is in favour of the non-resident, from a *source* within or deemed to be within South Africa, is subject to tax in South Africa, subject to certain exceptions. Therefore, the connecting factor between a non-resident and South Africa's right to tax depends on whether the income generating activity took place *within* South Africa's borders (Olivier and Honiball, 2011:11).

Effective from 1 January 2001, South Africa applied the residence basis of taxation in respect of years of assessment commencing on or after this date, meaning that persons considered resident in the Republic are taxed in the Republic on their worldwide income irrespective of where the income was earned (SARS Interpretation Note 16, 2021; Olivier and Honiball, 2011:849). Therefore, the connecting factor between the taxation of the income and the Republic is the *residence of the person* receiving or accruing the income in question (Olivier and Honiball, 2011:19). The concept of 'residence' is central to the residence-based system of taxation and is the first point of departure in the determination of tax liability in the Republic. South Africa does not adopt citizenship, like the United States, nor domicile, like the United Kingdom, as a basis of taxation, where a person's status under public and private law is used to determine whether such a person should be taxed in a particular country (Olivier and Honiball, 2011:46-47).

The definition of a 'resident', as contained in Section 1 (a) of the Act, is applied in order to determine an individual's status for tax purposes. Section 1 of the Act defines a resident, in relation to a natural person, as a person who is either ordinarily resident in the Republic, or, if not at any time ordinarily resident during the relevant year of assessment, if the requirements of the physical presence test are met. This test is based on the number of days that the person is physically present in the Republic, and in South Africa physical presence denotes:

- 91 days in aggregate during the year of assessment under consideration;
- 91 days in aggregate during each of the five years of assessment preceding the year of assessment under consideration; **and**
- 915 days in aggregate during the five preceding years of assessment.

The reader should note that the focus of this study is not an analysis of the physical presence test in relation to the set of facts at hand. Instead, it is accepted that Lucy, the proxy South African expat rendering services in the UAE, remains ordinarily resident in South Africa for the 2021 year of assessment. Furthermore, the physical presence test cannot apply in a year during which the taxpayer was ordinarily resident in South Africa.

The relationship between a country's domestic law and the DTAs it concludes with other Contracting States is relevant to this study. The right to tax certain income imposed by a DTA finds its origins in the domestic laws of a state, therefore, it is domestic law which imposes tax on certain income and DTAs which limit or relieve the amount of tax that should be levied in terms of the agreement (Arnold, 2016:138). The provisions of a DTA are not intended to entirely displace the domestic law provisions of two Contracting States. Instead where for example a person is considered to be a resident of both country X and country Y, the tie-breaker rule in the DTA between the two countries ensures that such a person who is considered dual-resident is deemed a resident of only one country for purposes of the DTA (Arnold, 2016:138). The general rule is that the provisions of a DTA prevail and override the provisions of domestic law in the event of a conflict between the two, since DTA provisions are considered to be special (*lex specialis*) and are governed by the principle of *pacta sunt servanda* which means that agreements must be honoured (Arnold, 2016:139).

Where a natural person is deemed to be exclusively resident in another country in terms of a DTA, then such a person is no longer regarded as a resident for South African purposes (Article 4(1) and 4(2) treaty tie-breaker rules of the OECD MTC). It is important to take note of the international perspective on residency, because whilst South Africa is not a member of the OECD, it enjoys Official Observer status (International Relations and Cooperation: 2004). For this purpose, Article 4(1) of the OECD MTC refers to a 'resident of a Contracting State' as a person who 'under the laws of that State' is liable to tax. It is clear that Article 4(1) emphasises that residency is determined by the domestic laws of each Contracting State, however, when both States view an individual as resident (i.e. dual-resident) then the DTA tie-breaker rule has the deciding vote.

2.2.2. Ordinary residence

The term 'ordinarily resident' is not defined in the Act and consequently the term has been interpreted over time by local and international courts through the legal doctrine of *stare decisis* (Tax Consulting South Africa, 2019: 65). The seminal case on the term 'ordinarily resident' is *Cohen v Commissioner for Inland Revenue* 1946 AD 174, 13 SATC 362. This case dealt with whether a person, domiciled in South Africa, who was not physically present in South Africa for an entire year of assessment, could qualify as 'ordinarily resident' in South Africa, if it was accepted that the taxpayer's travels abroad were temporary and that he and his family would ultimately return to their home in South Africa.

In South Africa, the taxpayer leased a flat for a period of five years which contained the taxpayer's own furniture and in the taxpayer's absence, it was sub-let, fully furnished, during the year of assessment in question. The question as to whether the taxpayer qualified as 'ordinarily resident' arose due to the fact that he received dividends from public companies in South Africa. In the court a quo, Murray J in dismissing the taxpayer's appeal, held that in determining an individual's ordinarily resident status in any particular year of assessment, the taxpayer's conditions of ordinary residency could be determined by evidence as to his or her mode of life outside the year of assessment in question. Schreiner JA concurred with this statement (*Cohen v Commissioner for Inland Revenue, 1946:364, 373*).

In the Appellate Division, Schreiner JA held obiter dictum:

"If, though a man may be "resident" in more than one country at a time, he can only be "ordinarily resident" in one, it would be natural to interpret "ordinarily" by reference to the country of his most fixed or settled residence… his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings, as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home" (Cohen v Commissioner for Inland Revenue, 1946:371).

It is evident from the outcome of *Cohen v Commissioner for Inland Revenue* 1946 AD 174, 13 SATC 362 that a taxpayer may be ordinarily resident in South Africa despite being absent from the country for the whole of the tax year. In *H v Commissioner of Taxes* 1960 (2) SA 695 (SR) the High Court of the former Southern Rhodesia held that in determining whether the taxpayer was resident in the British colony of Southern Rhodesia, the permanent place of abode could be identified as the place where the belongings of the taxpayer were stored, the place which the taxpayer left for temporary absences, and the place to which he or she regularly returned after such absences (*H v Commissioner of Taxes,* 1960:698).

Similarly, *in R v Barnet London Borough Council, ex parte Shah and other appeals* (1982) 1 ALL ER 698 the court held that the place where a person is habitually and normally resident is the place where he or she is ordinarily resident. This holds true despite occasional or temporary absences from a country. According to the court in *ex parte Shah*, the intention to return to a person's "real home" will outweigh any absences of long or short duration (*R v Barnet London Borough Council, ex parte Shah and other appeals* (1982) 1 ALL ER 698:704).

The *Cape Special Court in Income Tax Case No 1170* (1971) 34 SATC 76 (C) was tasked with determining whether the taxpayer was ordinarily resident in South Africa for the year of assessment ended in February 1970 after spending fourteen months in the United States of America on assignment. The taxpayer, accompanied by his family, departed for the U.S. leaving behind in South Africa a house owned by the taxpayer, permanent employment by a company situated in South Africa, the taxpayer's parents, and a savings bank account. The family home was let out for the fourteen-month period that the family as a whole spent in the U.S.

Life in the U.S. appealed to the taxpayer who started looking for other employment abroad whilst in the U.S. in an effort to remain overseas permanently. However he was not able to secure suitable employment (*Cape Special Court in Income Tax Case No 1170*, 1971:77). Whilst in the U.S. the taxpayer received his salary paid by his South African employer and objected to its inclusion in his South African income tax return, stating that it should not form part of his gross income as it was not received by nor accrued to him from a source within the Republic (*Cape Special Court in Income Tax Case No 1170*, 1971:77).

Watermeyer J held that the taxpayer's absence from South Africa was temporary in nature, and endorsed the approach in *Cohen v Commissioner for Inland Revenue* 1946 AD 174, 13 SATC 362, stating that there is little doubt that while the taxpayer spent a period of time in the U.S., South Africa was his ordinary residence by way of the house he owned there, the fact that the company providing him with permanent employment was situated there, that his parents continued to lived there, and that he had a savings account still open in the country (*Cape Special Court in Income Tax Case No 1170*, 1971:78). The case illustrates that although the taxpayer entertained the possibility of living and remaining overseas, no definite decision had been made in this regard and therefore no other country except South Africa could be regarded as the taxpayer's ordinary residence (SARS Interpretation Note 3, 2018:3).

Finally, in 1992 the Appellate Division handed down judgment in *Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A) which was centred around the question of Mr. Kuttel's ordinarily resident status in South Africa and whether this prevented him from benefitting from the exemption from dividends tax afforded in Section 10(1)(k)(ii) of the Act to persons not ordinarily resident in the Republic. In the Kuttel case, the taxpayer emigrated from South

Africa to the United States of America together with his spouse, after having obtained a permanent residence permit in 1983. In the U.S. the taxpayer established a home in Fort Lauderdale. He established a church membership, opened bank accounts, bought a car, acquired an office, and registered for social security (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A):151-152).

The taxpayer's three children permanently joined their parents after completing secondary schooling in South Africa and thereafter the family of five became citizens of the U.S. Despite having emigrated from South Africa, the taxpayer retained a family home in Cape Town which was owned by a South African company in which he and his wife were sole shareholders. Renovations and extensions were carried out on the house in order to safeguard the taxpayer's assets from a devaluation in the value of the rand. The house was never let out and was always available to the taxpayer. Due to exchange control regulations the taxpayer asserted that he was prohibited from taking his assets out of the Republic and that, but for these regulations, he would certainly have done so. One-third of the taxpayer's time during the thirty-one-month period under review by the Commissioner was spent in South Africa which was a factor contributing to the Commissioner's assessment that the taxpayer was in fact ordinarily resident in South Africa (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A):151-152).

In his judgment, Goldstone JA adopted the formulation of Schreiner JA in the Cohen case and reinforced that a person is "ordinarily resident" where he has his usual or principle residence in what can otherwise be described as his real home. The learned judge stated the following:

'I would respectfully adopt the formulation of Schreiner JA and hold that a person is "ordinarily resident" where he has his usual or principle residence, ie what may be described as his <u>real home</u>.' (emphasis added).

Commissioner for Inland Revenue v Kuttel 1992 (3) SA 242 (A):156(1).

Goldstone JA recognised that a person may have more than one residence at any one time, however the term 'ordinarily resident' is narrower that the term 'resident' and should be given its ordinary and natural meaning (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA

242 (A):155). Referencing the facts and circumstances, Goldstone JA stated that there can be no doubt that at the relevant times the taxpayer was not ordinarily resident in the Republic, placing emphasis on the fact that the taxpayer made a decision to immigrate to the U.S. and that pursuant to that decision, he and his spouse had set up a home there (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A):156). Furthermore, the visits which the taxpayer made to the Republic became less frequent in the thirty-one-month period and these visits were not associated with a “return home” but were primarily for business purposes (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A):156). Lastly, regarding the taxpayer’s assets, but for the exchange control provisions in place in the Republic, the taxpayer would have taken these with him to the U.S. which is further illustrative of the taxpayer’s intention to emigrate from South Africa (*Commissioner for Inland Revenue v Kuttel* 1992 (3) SA 242 (A):156).

Drawing from the principles underlying the term ordinarily resident enunciated in the *Cohen* and *Kuttel* dicta, the term can be summarised as follows:

- Ordinary residence refers to a taxpayers ‘real home’, it is the place where they would as a matter of course return to from their wanderings.
- When enquiring into a taxpayer’s ordinary residence, the facts and circumstances extending beyond the year of assessment are also relevant.
- South African courts will assess the various objective and subjective factors of a particular case as a matter of degree.
- Whilst a taxpayer may be resident in more than one country at any time, he or she may only be ordinarily resident in one country.
- Physical presence alone does not precipitate ordinary residence. Instead, the purpose, nature and intention of the taxpayer needs to be considered as part of all the facts necessary to determine the question of ordinary residence.

The meaning of the term ‘ordinarily resident’ is confirmed in SARS Interpretation Note 3 as the place where a natural person has his or her usual or principal residence (SARS Interpretation Note 3 (Issue 2), 2018:9). Section 89(3) of the TAA on ‘Binding general rulings’ provides that a senior SARS official may issue a ‘binding general ruling’ as an interpretation note or in another form and this may be issued in the manner that the Commissioner prescribes.

Furthermore, an 'official publication' as defined in Section 1 of the TAA, means 'a binding general ruling, interpretation note, practice note, or public notice issued by a Senior SARS official or the Commissioner'. According to Section 5 of the TAA, a 'practice generally prevailing' constitutes a practice which is provided for in an official publication and deals with how the Act should be applied or interpreted. Therefore, it is clear that a practice generally prevailing, such as the ability of SARS to settle a dispute with a taxpayer if it is to the best advantage of the State (Section 146 of the TAA), will have an impact on the rights of taxpayers.

The Constitutional Court in *Marshall NO and Others v Commissioner for SARS* (CCT208/17 [2018] ZACC 11 (25 April 2018) at 6) held that the 'unilateral practice' of SARS as an executive arm of government should not be considered when interpreting legislation and further, that only in instances where the interpretation notes are recognised by 'all concerned', i.e. SARS and the taxpayer, can it be justified to use the interpretation notes in the interpretation of legislation.

In a recent judgment of *ABC (PTY) Ltd v the Commissioner for the South African Revenue Service* (13950) [2020] ZATC 8 (24 February 2020] at 13-14, Bam J recognised the Constitutional Court's judgment in *Marshall NO and Others v Commissioner for SARS* (CCT208/17 [2018] ZACC 11 (25 April 2018)) and highlighted that in the case at hand, both the applicant and the respondent placed reliance on SARS Practice Note 7, 1999 and therefore displayed that application of the interpretation note when interpreting Section 31(2) of the Act was recognised by all parties.

Whist noting the caution with which Interpretation Notes should be followed as held by the Constitutional Court in *Marshall NO and Others v Commissioner for SARS* (CCT208/17 [2018] ZACC 11 (25 April 2018)), South African legal jurisprudence and SARS are aligned in deciding on the question of whether a natural person is ordinarily resident in a county. A factual inquiry is necessary to establish whether a natural person is ordinarily resident in South Africa, and SARS Interpretation Note 3 provides that the following non-exhaustive factors will be considered in the inquiry:

- 'An intention to be ordinarily resident in the Republic;
- The natural person's most fixed and settled place of residence;

- The natural person's habitual abode, that is, the place where that person stays most often, and his or her present habits and mode of life;
- The place of business and personal interests of the natural person and his or her family;
- Employment and economic factors;
- The status of the individual in the Republic and in other countries, for example, whether he or she is an immigrant and what the work permit periods and conditions are;
- The location of the natural person's personal belongings;
- The natural person's nationality;
- Family and social relations (for example, schools, places of worship and sports or social clubs);
- Political, cultural or other activities;
- That natural person's application for permanent residence or citizenship;
- Periods abroad, purpose and nature of visits;
- Frequency of and reasons for visits'.

Source: SARS Interpretation Note 3, 2018:5.

A natural person who ceases to be ordinarily resident in the Republic cannot be considered resident under the physical presence test in the same year of assessment that ordinary residency was ceased, since Paragraph (i) of the definition of 'gross income' in Section 1 states that the physical presence cannot be applied in the year that the natural person ceases to be ordinarily resident (SARS Interpretation Note 3, 2018:7). It is prudent for taxpayers and tax practitioners to understand and comprehend the rules relating to tax law interpretation, because the burden of proof on a balance of probabilities rests with the South African outbound expat in being able to deduce evidence to the effect of their ordinarily resident status in South Africa, which might rely or turn on some of the factors listed above in Interpretation Note 3 (Tax Consulting South Africa, 2019: 70-72).

Importantly, as per the dicta provided above, as well as the guidance provided by Interpretation Note 3, the facts and circumstances of the natural person are to be examined as a whole, taking into account facts and circumstances of the person's mode of life before and after the year of assessment concerned (SARS Interpretation Note 3, 2018:5-7). For purposes of application of a tax treaty, a natural person who is considered exclusively resident in another country by the tie-breaker clause, will not be deemed a resident for South African income tax purposes. The interplay between the definition of 'resident' in Section 1(1) of the Act and tax treaties is evident in Section 108 of the Act. Section 108 of the Act provides that the National Executive may enter into agreements with the governments of other countries with the purpose to prevent, mitigate or discontinue the levying of tax in South Africa and the other country on the same income. It further provides that once a DTA as contemplated in Section 231 of the Constitution is approved by Parliament and published in the Government Gazette, the DTA is deemed to be enacted in the Act. Therefore, in South Africa, a treaty takes effect on the date that it is published in the Government Gazette and has the *same* constitutional status as provisions of the Act.

The question as to whether a tax treaty's provisions take precedence over domestic taxing legislation contained in the Act was answered in *Commissioner of SARS v Tradehold* 2013 (4) SA 184 (SCA), 74 SATC 263 at 269 Paragraph 17, where Boruchowitz AJA stated that since DTAs allocate taxing rights between contracting states, they achieve the objective of Section 108 of the Act and therefore it can be said that DTAs modify domestic law and will apply in preference to domestic law to the extent that there is a conflict.

The maxim *generalia specialibus non derogant* provides that in instances where a conflict exists between the general definition of the term in Section 1(1) of the Act and a more specific definition in a tax treaty, the more specific provisions of a treaty would take precedence over provisions of general application (SARS Interpretation Note 3, 2018:8). Clearly, where a DTA provides a more specific tax treaty definition of a term, it will override the term generally defined in South African domestic law. Provision is also made in Section 1(1) of the Act for the exclusion of any natural person who is deemed to be a resident of another country for purposes of applying any tax treaty. Effectively, this upholds the general principle of international law *pacta sunt servanda,* which means 'agreements must be kept' when directly translated.

In summary, ascertaining a natural person's residency status is paramount in determining the tax obligations to be assigned to that person in a given country. South Africa follows the residence basis of taxation and in terms of the Act, this is dependent on whether the natural person is 'ordinarily resident' in South Africa, or fulfils the requirements set out in the physical presence test. The ordinarily resident test entails an inquiry into the objective circumstances surrounding a taxpayer, as well as the extent to which he or she can prove residency in one country and not in another during the period in question. Determination of residency status by way of a DTA shall prevail over the status assigned through application of Section 1(1) of the Act.

2.2.3. Tax residency under a DTA

Article 4(1) of the OECD MTC 2017 provides that for the purposes of an agreement, a 'resident of a Contracting State' means any person who, under the laws of that State, is liable for tax therein by reason of that person's domicile, residence, place of management or any other criterion of a similar nature. This definition encompasses the concept of residence which is adopted in the domestic laws of a State (Paragraph 8 of the OECD's Commentary on Article 4). In many States, the 'liable to tax' criterion contained in Article 4(1) of the OECD MTC 2017 takes on the meaning of being considered resident in a Contracting State for purposes of taxation, but not necessarily subject to tax in that Contracting State (e.g. a charity in country A may be exempted from taxation but is only exempt if all requirements stipulated in a country's tax laws are met) (Paragraph 8.11 of the OECD's Commentary on Article 4). A person may be liable for tax in South Africa by virtue of being ordinarily resident in the country, whilst at the same time be liable for tax in another State where he or she is domiciled based on the principle of 'source' (Tax Consulting South Africa, 2019:89). It must be noted that should a dual resident person seek to apply the DTA tie-breaker test, he or she must disclose this intention to SARS and be able to provide evidence that he or she is a resident for purposes of tax in a Contracting State, through the provision of a valid certificate of tax residency issued by the tax authorities of the other Contracting State source (Tax Consulting South Africa, 2019:91-92).

2.2.3.1. The status of treaties in South Africa

Model tax conventions such as the OECD's MTC 2017 and to a lesser degree, the UN MTC 2017, have formed the basis of most modern-day income tax treaties (Arnold, 2016; Olivier and Honiball, 2011). South African DTAs are largely based on the OECD MTC with deviations which align to the UN MTC in some DTAs (Tax Consulting South Africa, 2019:88).

The fundamental objective of tax treaties, broadly stated, is to facilitate cross-border trade (through the free-flow of persons, goods, services and capital across country borders) and investment by eliminating the tax impediments to these cross-border flows and establishing boundaries of taxation on certain types of income (Arnold, 2016:6). From the perspective of taxpayers, the most important operational objective of bilateral tax treaties is the elimination of juridical double taxation (as opposed to economic double taxation where more than one person is taxed on the same item of income), which arises in two instances (OECD Glossary of Tax Terms, 2021):

1. If the country of residence of an investor makes use of the residence basis of taxation and therefore imposes tax on the foreign income of the investor/recipient, and the source country of investment applies the source basis of taxation to the same income, resulting in the income being taxed twice i.e. the 'residence/source conflict' (Arnold, 2016; Oguttu, 2018); and
2. Where an investor/recipient of income is deemed to be resident in both jurisdictions asserting the right to tax the same income i.e. the 'residence/residence conflict' (Olivier and Honiball, 2011).

Several provisions of the typical bilateral tax treaty are directed at the elimination of potential juridical double taxation stemming from discriminatory tax practices based on the nationality of taxpayers, which is prevented in Article 24 of the OECD MTC 2017 and UN MTC 2017. For example, tax treaties contain tie-breaker rules (Article 4(2) and (3) of the OECD and UN Model Treaties) to deem a taxpayer who is otherwise resident in both countries to be a resident of only one of the countries for purposes of applying a treaty. They also limit or eliminate source country taxation on certain types of income (Articles 10, 11 and 12 of the OECD and UN MTCs) and require residence countries to provide relief for source country taxes either by way of a foreign tax credit or an exemption for the foreign source income (Article 23 of the OECD and UN MTCs).

Another equally important operational objective of bilateral treaties is the prevention of tax evasion and avoidance through *inter alia* the exchange of tax information and encouraging assistance in the collection of taxes between Contracting States (Article 26 and Article 27 of the OECD MTC 2017 and UN MTC 2017). This objective is the converse of the elimination of double taxation. Tax treaties are intended to eliminate double taxation of cross-border income but are not intended to facilitate double non-taxation. The underlying assumption of tax treaties is that cross-border income should be taxed, however it should only be taxed once. For Contracting States, the objects of a tax treaty are, for example, to determine whether the particular State has the right to tax the income and to ask for assistance in the collection of outstanding revenue or to obtain information.

Section 108 of the Act empowers the National Executive of South Africa to enter into DTAs with the government of another country in a quest to prevent, mitigate or discontinue the levying of tax, whether in the Republic or in the Contracting State, on income, profit or gains. The definition of 'resident' under Section 1 of the Act promotes the sanctity of DTAs in stipulating that residency can be determined within the meaning of an applicable DTA where a person shall be *deemed* to be exclusively a 'resident of a Contracting State' (Article 4(2) of the OECD MTC of 2017). This applies regardless of whether the individual is ordinarily resident or meets the physical presence test during a particular year of assessment in South Africa (Van Zyl, 2020:15). Section 231 of the Constitution empowers the national executive arm of the state to negotiate and enter into international agreements which are binding on the Republic, i.e. a tax treaty, (Section 231(1) and (5) of the Constitution), and furthermore, that an international agreement becomes law in the Republic when it is enacted into law by national legislation (Section 231(4) of the Constitution).

Regarding the interpretation of legislation, Section 233 of the Constitution stipulates that every court must prefer any reasonable interpretation of the legislation that is consistent with international law. Olivier and Honiball (2011) state that treaty interpretation should encompass an interpretation in the context of its international status, as well as its context under domestic law, since treaties have a dual nature. Arnold (2016) aptly states that treaties should be interpreted differently from domestic tax legislation for the following reasons:

1. Tax treaties are bilateral (i.e. a contract between two states creating rights and obligations between them) and encompass the intentions and domestic tax legislation of both Contracting States;
2. Terms used in domestic legislation might not appear in tax treaties, since most modern treaties are based on the OECD MTC or to a lesser degree, the UN MTC;

3. Tax treaties do not impose tax unlike domestic tax legislation, rather they impose boundaries and limits on the taxes that may be imposed by the Contracting States; and
4. The OECD MTC and its Commentary, and the UN MTC, are unique international instruments distinct from domestic tax legislation.

Customary international law governs the interpretation of tax treaties, specifically the Vienna Convention on the Law of Treaties which is codified and thus binding on all nations (Arnold, 2016). According to Article 31(1) of the Vienna Convention, a treaty is to be interpreted in *good faith* and in accordance with the ordinary meaning to be given to its terms, taking cognisance of their context in light of the object and purpose of the treaty. Thus, the first step in interpreting a treaty is to consider the ordinary meaning of the words in the treaty and their context against the backdrop of the object and purpose of the treaty. To the extent of undefined terms, Article 3(2) of the Vienna Convention provides that the domestic law of the country applying the treaty should be utilised unless the context of the treaty term requires otherwise. This provision is replicated in Article 3(2) of both the OECD MTC 2017 and the UN MTC 2017. According to Arnold (2016), a country applies a treaty when it makes use of a relevant action provided for in the treaty, such as issuing a ruling or the assessment of tax.

'Context' in terms of Article 3(2) of treaty terms can be found in the preamble of the treaty, any ancillary agreements to the treaty, and any annexes (Olivier and Honiball, 2011:309). The authority for taking the OECD MTC Commentary into account in interpreting a specific tax treaty can be found in Article 32 of the Vienna Convention, however it should not be taken into account as the primary source of interpretation. Section 232 of the Constitution clearly states that customary international law is a source of South African law, unless it is inconsistent with the Constitution itself or an Act of Parliament. Therefore whilst South Africa is not a signatory to the Vienna Convention, the Vienna Convention is a codification of customary international law and South Africa should be guided by the Convention in interpretation of treaties (Olivier and Honiball, 2011).

In the South African case of *Secretary for Inland Revenue v Downing* 37 SATC 249 at 255 which dealt with profits accruing to a Swiss resident from sales of shares made on his behalf by a stockbroker resident in Johannesburg in the course of managing the Swiss resident's investment portfolio, the Appellate Division took cognisance that the OECD MTC has served as the basis of the "veritable" network of treaties, and drew on the Commentary to interpret provisions in the DTA between South Africa and Switzerland. Furthermore, the Supreme Court of Appeal in Commissioner for the *South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) at 23 decided on the effect of a company ceasing to be a resident of a Contracting State (or treated as a non-resident for purposes of the treaty) for the purposes of a DTA and the disposal of that company's assets. Boruchowitz AJA stated in Paragraph 21 that the need to interpret international treaties in light of the purpose of the treaty and being aware that the interpretation should be congruent with the words employed in the treaty is a well-established principle.

2.3. FOREIGN REMUNERATION INCOME EXEMPTION

A South African tax resident who earns certain types of remuneration for employment services rendered outside South Africa for a certain period qualifies for the Section 10(1)(o)(ii) partial exemption in the Act. The first requirement relates to the type of remuneration qualifying under Section 10(1)(o)(ii) of the Act and encompasses remuneration in the form of a salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, or any amount referred to in Paragraph (i) of the definition of "gross income" in Section 1(1), or any amount referred to in Section 8 (allowances, advances and reimbursements), Section 8B (amounts derived from broad-based employee share plans and the taxation thereof), or Section 8C (vesting of equity instruments and the taxation thereof on directors and employees) of the Act (SARS Interpretation Note 16 [Issue 4]:2).

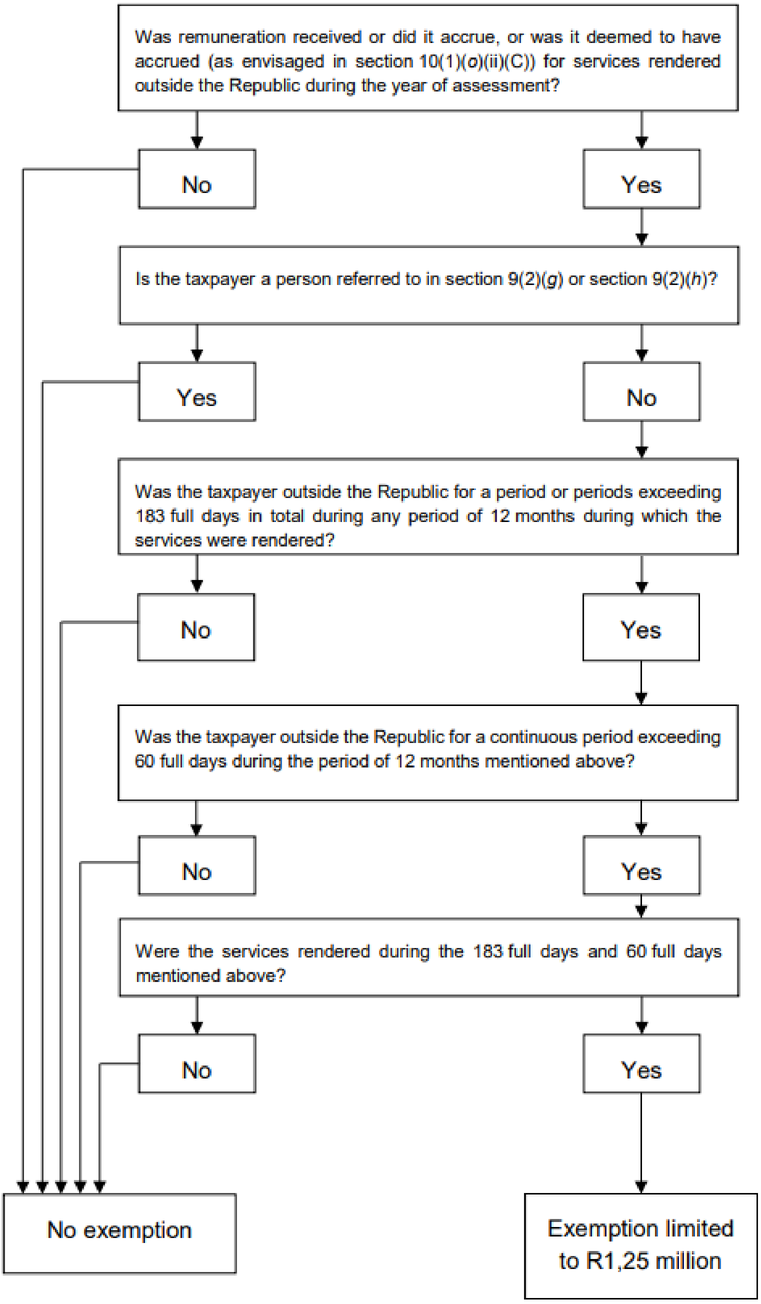
According to Interpretation Note 16, the remuneration must have been received by the natural person in respect of services rendered relating to an employment relationship. This means that the remuneration must relate to amounts payable by an employer to an employee to be included in the scope of the partial exemption (SARS Interpretation Note 16 [Issue 4]:3). Payment received in lieu of termination of an office of employment is not in respect of services rendered and is subsequently excluded from the ambit of the Section 10(1)(o)(ii) exemption (SARS Interpretation Note 16 [Issue 4]:3).

SARS Interpretation Note 16 states that the term 'an employer' means that any services rendered to a resident or non-resident employer could qualify for the exemption. The ordinary meaning is given to the term ‘employee’ as it is not defined in the main body of the Act, and therefore excludes independent contractors and self-employed persons. Furthermore, this study will not focus on employees which are expressly excluded from the exemption, namely public office holders as defined in Section 9(2)(g) and employees of employers as defined in Section 9(2)(h) of the Act. Additionally, it must be noted that whilst ‘employee’ is defined in Paragraph 1 of the Fourth Schedule, it is not applicable for purposes of application of the Section 10(1)(o)(ii) exemption (SARS Interpretation Note 16 [Issue 4]:3).

The South African expat must be in an employment relationship which requires that services are rendered outside the Republic for at least 183 full days during any 12-month period. The ‘Republic’ includes the area defined as the exclusive economic area and continental shelf (SARS Interpretation Note 16 [Issue 4]:4). If a natural person’s employment services relate to exploring or exploiting natural resources, then remuneration for services rendered beyond South Africa’s territorial seas but within the exclusive economic zone or on the continental shelf do not qualify for Section 10(1)(o)(ii) exemption (SARS Interpretation Note 16 [Issue 4]:3). Employment of the natural person outside the Republic must be at least 183 full calendar days during any 12-month period and a ‘full day’ means 24 hours (from 0h00 to 24h00) (SARS Interpretation Note 16, 2021:4).

With respect to the 2020 and 2021 years of assessment, the Taxation Laws Amendment Act, 2020 has relaxed the 183 full days requirement and reduced it to 117 full days, however, the 60 consecutive days requirement remains applicable within the same period that the 117 days have been met within these years of assessment (KPMG, 2020). The criteria applicable for qualification of the exemption afforded in Section 10(1)(o)(ii) of the Act are displayed in the figure below. Practically, this means that in order to successfully claim the exemption in the 2020 and 2021 years of assessment, a South African resident would need to have remained outside the Republic for more than 60 consecutive days during a 117-day period (SARS Interpretation Note 16, 2021).

Figure 3: Section 10(1)(o)(ii) exemption in the Act



Source: SARS Interpretation Note 16 [Issue 4]: 19 (2021)

2.2.4.2. Treaty tie-breaker test

It is possible that a natural person is regarded as resident under the domestic laws of two countries concomitantly. Article 4(2) of the OECD MTC governs instances of dual residency by considering different factors in order of preference with a view to assigning the residency of a person to a single country (Tax Consulting South Africa, 2019:91). The DTA governs which Contracting State enjoys taxing rights over the income in question, or whether both states may tax the income in question (Oguttu, 2018:316-317). Should the DTA tie-breaker rule be utilised by a natural person who is ordinarily resident in South Africa, the person will need to provide evidence that he or she is a resident of the other country in order to escape residence status in South Africa (Tax Consulting South Africa, 2019:65).

Evidence constituting a certificate of tax residence may be furnished to SARS in order to prove tax residence status in another country (Tax Consulting South Africa, 2019: 65). There are no tax laws governing individuals in the UAE, and as such, no personal income tax imposed on the income of individuals working in the UAE, therefore, no domestic concept of personal tax residence exists (Deloitte, 2021:18). Despite this, the Federal Tax Authority of the UAE issues tax residence certificates to natural persons provided that a DTA exists between the UAE and the country asserting dual residency of the natural person. The certificate covers a period of 12 months from the start date specified by the applicant (UAE Federal Tax Authority, 2021). However, the applicant must have been a resident of and must have been physically present in the UAE for more than 180 full days within the specified period (UAE Federal Tax Authority, 2021; Deloitte, 2021:18).

Pertinent to the permanent home criterion, which is within the scope of this study, natural persons must attach a certified annual lease agreement or tenancy contract copy which is officially documented by the competent authorities such as EJARI in Dubai, which is an electronic rental registration platform (UAE Federal Tax Authority, 2021). Additional documentary requirements consist of validated bank statements reflecting a 6-month period from a local bank in the UAE, evidence of the source of the employment income such as a salary certificate, a UAE residence Visa copy, or an Emirates ID and passport copy (UAE Federal Tax Authority, 2021).

Article 4(2) (a) to (d) of the OECD’s MTC contains the tie-breaker clause which sets forth a hierarchy of tests to determine a natural person’s residency status where such a person is considered tax resident in both contracting states.

1. In which contracting state is the individual’s permanent home situated?

2. If the individual's permanent home exists in both states, then the individual's centre of vital interests needs to be determined (i.e. where are the individual's personal and economic relations closest)?
3. If the individual does not have a permanent home available to him in either state, and one fails to establish the state in which the individual's centre of vital interests is evidenced, then the matter of course is to determine where the individual's habitual abode is (this leg of the test refers to, *inter alia*, the period of time a taxpayer spends in each country (OECD Glossary of Tax Terms, 2021)).
4. If the individual's habitual abode is in both states (or in neither state), then one would need to determine the country in which the individual is a national (this refers to the country where the individual is a citizen).
5. If the individual is a national of both states (or in neither state), then the competent authorities of the contracting states shall settle the residency status of the individual by way of mutual agreement (Article 24 of the SA/UAE DTA).

The first question contained in Article 4(2)(a) of the OECD MTC concerning the 'permanent home' of the individual will be analysed, as the others have been excluded from the scope of this study.

2.2.4.3. Permanent home test

The permanent home criterion in a DTA finds its application when an individual is considered dual resident for purposes of a DTA. Article 4(2)(a) of the OECD MTC gives preference to the country where the natural person has a permanent home and this denotes a degree of permanency, as opposed to staying at a place where the conditions suggest that the stay is intended to be of short duration (Paragraph 11-12 of the Commentary on Article 4 of the OECD MTC; Tax Consulting South Africa, 2019: 93).

According to Paragraph 11 of the Commentary on Article 4 of the OECD MTC, this first criterion frequently suffices to solve the deadlock around residency, e.g. where an individual has a permanent home in Contracting State A but is physically present in Contracting State B for a certain period of time. The Commentary on Article 4 of the OECD MTC elaborates on what a permanent home is and defines it as the 'place where the individual owns or possesses a home' and that this 'home' is 'permanent' (Paragraph 12 of the Commentary on Article 4 of the OECD MTC).

2.2.4.3.1. The concept of 'home' and 'permanence'

The OECD Commentary is persuasive authority in interpreting treaty provisions which are based on the OECD MTC, and since the SA/UAE DTA generally follows the OECD MTC (2008) version, the OECD Commentary (2017) will be utilised for interpretive purposes (*AB LLC and BD Holdings LLC v The Commissioner for the South African Revenue Service* (13276) (2015) ZATC 2 (15 May 2015):11-12;[1] IBFD, 2015). The OECD Commentary on Article 4 at Paragraphs 11 and 16 state the following:

'The Article gives preference to the Contracting State in which the individual has a <u>permanent home available to him</u>. This criterion will frequently be sufficient to solve the conflict, e.g. where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State….If the individual has a permanent home in both Contracting States, it is necessary to look at the facts in order to ascertain with which of the two States his personal and economic relations are closer' (emphasis added).

Therefore, in cases of dual residence, the permanent home test is the benchmark for the centre of vital interests criterion and other connecting factors (Resch, 2019:221). The term 'permanent home' is not defined in Article 4, however regarding the concept of 'home' the Commentary states that 'any form of home' may be considered, e.g. a house, apartment, caravan or rented furnished room, provided that the individual has arranged for this dwelling to be available to him on a permanent and continuous basis, with permanency being essential (Paragraph 13 of the Commentary on Article 4 of the OECD MTC). The wording of the OECD Commentary on Article 4 Paragraph 13 suggests that the meaning intended is *house*, in a physical sense, instead of *home*, in an abstract sense:

[1] Vally J held that 'If any treaty contains the same article as that of the OECD Model then it would not be uncommon to rely on the commentary of the OECD Model to interpret that article' (*AB LLC and BD Holdings LLC v The Commissioner for the South African Revenue Service* (13276) (2015) ZATC 2 (15 May 2015).

'As regards the concept of home, it should be observed that <u>any form of home may be taken into account</u> (house or apartment belonging to or rented by the individual, rented furnished room)' (emphasis added).

Another interpretation of the above wording is that the OECD intended for the predicate 'permanent' to qualify as 'home,' but only with respect to the timing criterion (i.e. being permanently available to the individual as a distinctive and decisive criterion) (Resch, 2019:220). Therefore, it is clear that a hotel room for example will not qualify as a home due to the fact that such a dwelling is not usually available to the individual on a permanent and continuous basis, it is only available in respect of occasional durations of stay (Olivier and Honiball, 2011).

Paragraph 13 of the Commentary is noteworthy since it expands on the concept of home and states that a house owned by a person cannot be considered available to him/her during a certain period if such a house has been rented out and effectively handed over to an unrelated party. However, should a person rent out his or her home to a related party, he or she would retain possession of his or her permanent home since the possibility of his or her staying there would be higher than if the lessee was an unrelated person (Paragraph 13 of the Commentary on Article 4 of the OECD MTC).

Paragraph 12 of the OECD Commentary provides that the meaning of 'permanent home' is considered to be the place where the individual owns or possesses a home, and this home is permanent. According to the OECD, a home is 'permanent' if the individual has arranged and retained it for the individual's permanent use as opposed to using the place for stays of short duration such as traveling for pleasure, business travel, and educational travel for example (Paragraph 12 of the OECD Commentary). The concept of a 'home' is observed in any form, for example, a house, an apartment belonging to or rented by the individual, and a rented furnished room.

2.2.4.3.2. The availability of the permanent home

The reader is cautioned into assuming that the adjective 'permanent' presupposes that the individual needs to permanently inhabit the home available, and rather that the correct interpretation of the OECD MTC is that the permanent home is available to the individual to be lawfully used by him or her at any time (Resch, 2019:212). The permanence of an abode connotes a place which is available to the individual at all times, continuously and not on an occasional or short-duration basis. Paragraph 13 of the OECD Commentary on Article 4 states that '… the permanence of the home is essential; this means that the individual has arranged to have the dwelling *available* to him at all times continuously, and not occasionally…' (emphasis added).

The OECD Commentary implies that as long as an individual *keeps* a home which is capable of being used at any time by the individual, and is therefore uninterrupted by the letting or renting of the home to third parties, this is sufficient to fulfil the permanent home test (Resch, 2019:224). However, the Australian Taxation Office has pointed out in its *Interpretative Decision ATO* ID 2012/93 that 'available' is defined in the Australian Oxford Dictionary, 2004, Rev. 2nd edition, Oxford University Press, as meaning 'capable of being used; at one's disposal'. The ATO in applying the ordinary meaning to the word 'available' found that since the taxpayer did not occupy his home at any time during the lease period, due to the existence of the lease agreement, he was incapable of occupying his home in Australia (Interpretative Decision ATO ID 2012/93, 2012).

From the day that it is established that an individual is deemed exclusively resident of a Contracting State for purposes of application of a DTA by way of a treaty tie-breaker clause, the individual ceases tax residency in South Africa. The foreign employment income earned outside the Republic is no longer exposed to South African income tax (even if the DTA awards taxing rights to South Africa) by reason of the source basis of taxation applying to non-residents (Paragraph 10 of the Commentary on Article 4 of the OECD MTC; Olivier and Honiball, 2011; Van Zyl, 2020).

2.2.4.3.3. Permanent home in neither Contracting State

According to the OECD's Commentary on Article 4 in instances where an individual has no permanent home available to them in either Contracting State, preference is given to the Contracting State where the individual has a *habitual abode* (Paragraph 16 of the OECD's Commentary on Article 4). The Commentary states further that in instances where no permanent home exists in either Contracting State and the person goes from one hotel to another '*all stays made in a Contracting State must be considered* without it being necessary to ascertain the reasons for them' (emphasis added).

To this end, Paragraph 19 of the Commentary states that in these instances a determination of whether the individual lived habitually, in other words, customarily or usually present, in one of the two Contracting States and not in the other, is required and is not simply determined to be the Contracting State where the individual spent the majority of his or her days (Paragraph 19 of the OECD's Commentary on Article 4). An assessment of the length of time spent in a Contracting State is but one of the factors which speak to the frequency, duration and regularity of the stays to paint a picture of the individual's settled routine. Due to the strong correlation between the permanent home criterion and the centre of vital interests criterion in the DTA tie-breaker clause, it makes sense that in situations where no permanent home exists, and therefore no personal or economic relations, since this presupposes a permanent home in both Contracting States, that the question turns to the third-level of the DTA tie-breaker, namely the habitual abode.

2.2.4.4. Implications of breaking tax residency

When South African tax residency is ceased, a specific anti-avoidance measure is triggered in the form of deemed disposals for capital gains tax purposes, otherwise known as "CGT exit tax" (Section 9H of the Act; Olivier and Honiball, 2011). This is also the case when tax residency is broken by way of the application of the tie-breaker clause of a DTA. The person is treated as having disposed of all of his/her assets equal to their market value on the date immediately before he/she ceases to be a resident. However, certain assets are excluded from the deemed disposal rule, for example immovable property located in South Africa (S9H(4)(a)). The reason for this is that the future disposal of such immovable property will be subject to capital gains tax in South Africa, being of a South African source (Section 9(2)(j) and Paragraph 2(1)(b) of the Eighth Schedule to the Act).

High net worth individuals who fall within the highest tax bracket and therefore represent a small tax base in South Africa due to continued inequality, are specifically targeted by the increased threshold on foreign employment income of R1.25 million in a bid to prevent these taxpayers from ceasing tax residency in South Africa (Bloomberg, 2021). These taxpayers are further disincentivised to cease tax residency in South Africa by the capital gains tax liability they face in the form of an exit charge on worldwide assets, excluding fixed property in South Africa (Section 9H of the Act). Therefore, it is clear that a trade-off exists between ceasing tax residency and remaining ordinarily resident in South Africa with both triggering tax liability in the country.

A person's tax liability is minimised by the application of DTA tie-breaker clauses in instances where the source state of the remuneration income imposes little or no tax. An example of this is where a South African individual who is a tax resident in both South Africa and the UAE is deemed a tax resident of the UAE through the application of the tie-breaker clause contained in Article 4(2) of the SA/UAE DTA (Article 4(2) of the OECD MTC). In light of the fact that the UAE has sole taxing rights on the employment income but does not levy any income tax, the individual will not pay any tax on the foreign employment income in either South Africa or in the UAE (Article 14 of the SA/UAE DTA; PricewaterhouseCoopers, 2021).

A further implication of ceasing to be a tax resident is the so-called 'lockdown' on retirement funds which was introduced as a result of the modernisation of the foreign exchange control system and the phasing out of emigration recognised by the SARB for exchange control purposes (so-called 'financial emigration') (National Treasury, 2021:8-9). As per National Treasury's Explanatory Memorandum on the Tax Laws Amendment Bill, 2020, from 1 March 2021, the withdrawal of funds from pension preservation funds, provident preservation funds and retirement annuity funds is only permitted when the member has:

- Ceased tax residency; and
- Remained a non-tax resident for a continuous period of at least three years on or after 1 March 2021 (TLAA, 2020).

The three-year test amends the immediate payment of lump sum benefits obtainable when a member of a pension preservation, provident preservation or retirement annuity fund withdraws from the fund as a result of 'financial emigration' from the Republic. This was achieved by amending the definitions of 'pension preservation fund', 'provident preservation fund' and 'retirement annuity fund' contained in Section 1 of the Act (National Treasury, 2021:8-9; de la Harpe, 2021).

CHAPTER 3: SOUTH AFRICA'S GENERAL ANTI-AVOIDANCE RULES

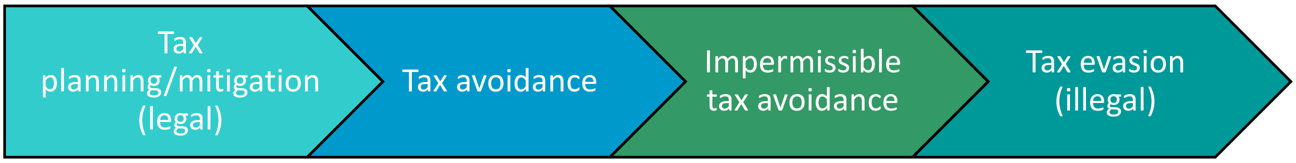
3.1. INTRODUCTION

The legality of a transaction within a South African tax context lies in the distinction between tax avoidance and tax evasion, and the final say rests with the courts (Olivier and Honiball, 2011: 509). Denis Healey, a former Chancellor of the Exchequer in the United Kingdom, remarked that the distinction between tax avoidance and tax evasion is the thickness of a prison wall, thin but solid (The Economist, 2000). The SARS Discussion Paper on Tax Avoidance (2005:3) provides that tax evasion, within a South African income tax context, involves the non-payment of tax that would ordinarily be paid if the taxpayer were transparent about his or her tax affairs and did not hide income or information from the tax authorities such as falsifying tax returns and entering into sham or disguised transactions (De Koker and Williams, 2021:par.19.1). Tax evasion is the wilful and conscious non-compliance with domestic tax law and in some instances, a reckless or negligent failure or *omissio* to abide by tax laws (Olivier and Honiball, 2011: 509).

According to De Koker and Williams (2021:par.19.1), tax avoidance equates to stratagems which are *prima facie* lawful until forbidden in law. In *Smith v Commissioner for Inland Revenue* 1964 (1) SA 324 (A) at 333 it was held that avoiding liability for tax meant 'to get out of the way of, escape or prevent an anticipated liability'. Tax avoidance has been described by some as 'nefarious', 'evil', and 'mischievous,' since it robs the *fiscus* of necessary contributions which subsequently places an additional tax burden on the taxpayers who exhibit a greater sense of civic responsibility (MacDonald JP in *Commissioner of Taxes v Ferera* (1976) 2 All SA 552 (RA) at 555). Simply put, the morality of tax avoidance is at question and not its legality. From a common law perspective, unless a specific anti-avoidance measure is triggered, the 'substance' of the transaction and not its 'form' is considered by a court and may be found to be impermissible avoidance (*CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA) at 1155).

'Impermissible tax avoidance' is central to the South African GAAR and lies between the classification of tax evasion on the one hand and legitimate tax planning on the other (De Koker and Williams, 2021:par.19.1). Figure 4 illustrates the four terms commonly used in discussions on tax avoidance and their proximity to one another.

Figure 4: The four terms commonly used in discussions on tax avoidance and their proximity to one another



Source: Adapted from Pidduck, The SA GAAR [video presentation], 2021.

In *Commissioner for Inland Revenue v Challenge Corporation Ltd* (1987) AC 155 at 168E, 'impermissible tax avoidance' applies in circumstances where a tax benefit results from an arrangement whereby a taxpayer's liability is reduced without there being any loss or expenditure which entitles the taxpayer to the reduction. Sections 80A–80L of the Act apply to impermissible tax avoidance arrangements. The GAAR, housed in Sections 80A–80L of the Act, attempts to balance a taxpayer's right to arrange his or her tax affairs in order to minimise tax liability and the need to protect the tax base of South Africa and preserve the liability for taxation on income in the hands of taxpayers (SARS, 2005:6; De Koker and Williams, 2021:par.19.33).

The GAAR operates to address tax avoidance schemes and is not intended to expose the 'loopholes' which give rise to impermissible tax avoidance (Pidduck, 2017:2). Broadly stated, Section 80A provides the definitional requirements of what constitutes an 'impermissible avoidance arrangement' and once such an arrangement exists, then Section 80B is triggered which confers on the Commissioner anti-avoidance powers to prevent or diminish the tax benefit which has arisen, or is set to arise as a result of the arrangement (De Koker and Williams, 2021:par.19.33).

An avoidance arrangement is defined as any arrangement which results in a tax benefit (De Koker and Williams, 2021:par.19.34). Section 80A, the capstone of the GAAR, defines an 'avoidance arrangement' as impermissible if the sole or main purpose of the arrangement was to obtain a tax benefit. In addition, only one of the so-called 'tainted elements' must be present in the avoidance arrangement for it to constitute an impermissible avoidance arrangement, namely:

- the arrangement was entered into or carried out in a means or manner which would not normally be employed for *bona fide* purposes, other than obtaining a tax benefit (Section 80A(b)); or
- it has created rights and obligations that would not normally be created between persons dealing at arm's length (Section 80A(c)(i)); or
- the arrangement would result directly or indirectly in the misuse or abuse of the provisions of the Act (including the provisions of Section 80A) (Section 80A(c)(ii)).

Section 80A differentiates between tainted elements present in transactions undertaken in the context of business and in a context other than business (Section 80A(a)(i) and Section 80A(b)). Transactions undertaken in the context of business need to be *bona fide* and require the judiciary to determine what a 'normal' business transaction in the normal course of business is in the absence of a tax consideration (Pidduck, 2019:11). In a context other than business, namely in a personal or private context, the judiciary needs to establish whether the means and manner employed to enter into or carry out the arrangement *would not normally be employed* for *bona fide* purposes other than to obtain a tax benefit (Section 80A(b) of the Act). The second one is where the arrangement has created rights or obligations which are not normally envisaged in a transaction between parties dealing at arm's length (Section 80A(c)(i) of the Act), and thirdly it must result, either directly or indirectly, in the misuse or abuse of provisions of the Act (Section 80A(c)(ii) of the Act).

An arrangement is widely defined in Section 80L of the Act as:

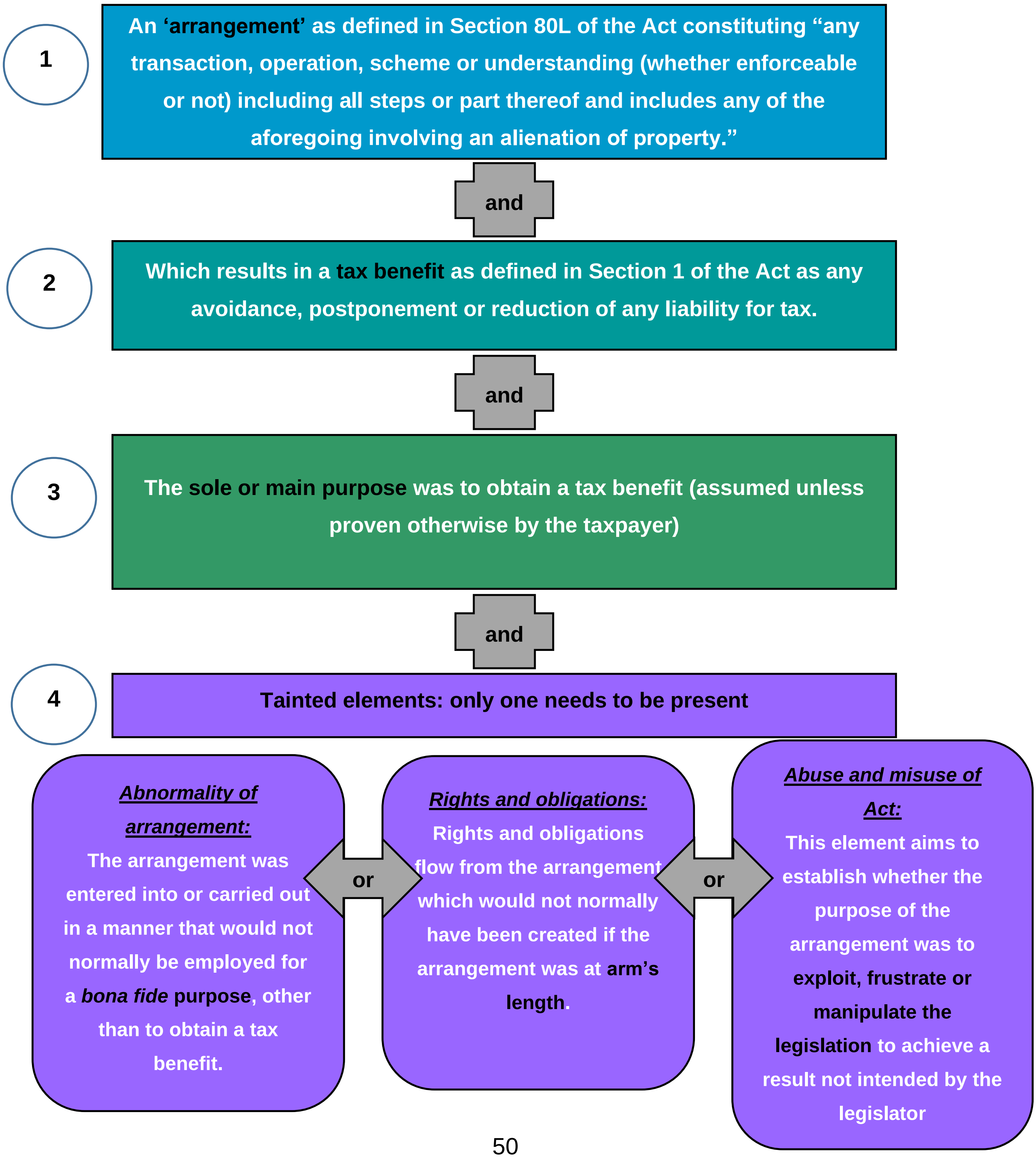
'any <u>transaction</u>, <u>operation</u>, <u>scheme</u>, <u>agreement or understanding</u>, including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property' (emphasis added).

Pidduck (2017:76) provides a concise summary of the four requirements of the South African GAAR contained in Section 80A which are as follows:

- There must be a transaction, operation or scheme present.
- Due to the presence of such a transaction, operation or scheme, a 'tax benefit' was obtained by the taxpayer.
- The taxpayer's sole or main purpose for entering into the transaction, operation or scheme was to obtain the tax benefit.

- The transaction, operation or scheme was entered into or carried out in a manner which would not normally be employed for *bona fide* purposes other than to obtain a tax benefit, which resulted in rights and obligations, which would not normally flow between persons dealing at arm's length, flowing to the taxpayer which equates to a direct or indirect misuse or abuse of the provisions contained in the Act.

Figure 5: The four requirements of Section 80A of the Act



Source: Own design

3.2. The legislative framework of the South African GAAR

The statutory general anti-avoidance rules contained in Section 80A–80L of Part IIA of Chapter III of the Act came into effect on 2 November 2006, replacing Section 103(1). Therefore, any arrangement or steps taken in an arrangement entered into on or after this date, could trigger application of the GAAR (De Koker and Williams, 2019:par.19.33). Arrangements entered into or steps taken in arrangements pre-November 2006 would likely be subject to the now repealed Section 103(1) of the Act, based on the presumption that legislation does not have a retroactive effect (De Koker and Williams, 2019:par.19.33).

In contrast to specific statutory anti-avoidance rules (SAAR), the GAAR does not target specific arrangements and is designed to counter arrangements aimed at the avoidance of tax in general and must be read in conjunction with specific anti-avoidance provisions. SAARs regulate or prohibit tax avoidance in specific situations or in relation to specific transactions and these rules are contained in various sections of the Act. SAARs should be considered in the first instance before the 'all encompassing' GAAR is considered to prevent use of impermissible avoidance arrangements (De Koker and Williams, 2019:par.19.33). The following sections in the Act are specific anti-avoidance provisions which have a specific target. For example, Section 9D of the Act is aimed at preventing South African residents from shifting tainted forms of taxable income outside the South African taxing jurisdiction by investing through a controlled foreign company, and Section 31 governs transactions between related parties where financial assistance is granted directly or indirectly by a non-resident to a resident company in an effort to curb transfer pricing and thin capitalisation.

Section 80A of the Act, the heart of the GAAR, provides the framework for classification of impermissible tax avoidance arrangements and reads as follows:

'An avoidance <u>arrangement</u> is an impermissible avoidance arrangement if its sole or main purpose was to obtain a <u>tax benefit</u> ***and*** *—*

… (b) in a <u>context other than business</u>, it was entered into or carried out by <u>means or in a manner</u> which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or

(c) in any context —

i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or

ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part)' (emphasis added).

Therefore, the GAAR, contained in Section 80A–80L of the Act defines the parameters of what constitutes an impermissible tax avoidance arrangement and sheds light on how the terms contained in the requirements of an avoidance arrangement are to be interpreted when uncertainty exists regarding the distinction between permissible and impermissible tax avoidance. It also empowers the Commissioner to act when an avoidance arrangement has been classified as impermissible by applying the GAAR to a step or part of the arrangement.

3.2.1. An exposition of the requirements of Section 80A–80L of the South African GAAR

Envisaged in the wording of Section 80A is an impermissible avoidance arrangement of which the sole or main purpose is to obtain a tax benefit in conjunction with one of the 'tainted' elements described in Section 80A(a)-(c). Four requirements need to be met in order to characterise an avoidance arrangement as 'impermissible' and therefore trigger application of the South African GAAR. The coupling of these four requirements is 'jurisdictional fact', meaning that all four requirements must exist before the statutory effect of the GAAR can be exercised, including the activation of the Commissioner's powers under Section 80B (De Koker and Williams, 2019:par.19.35). The structure and internal logic of Section 80A will be set out below.

3.2.1.1. Avoidance arrangements

The South African GAAR will only be applicable if there is an 'impermissible avoidance *arrangement*' (Section 80A of the Act). Therefore, the starting point is to establish whether an 'arrangement' exists. Section 80L of the Act provides that an 'arrangement' is defined as: 'any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property'.

Exploring deeper, the term 'avoidance arrangement' means any arrangement which results in a tax benefit. Therefore, the consensus is that an arrangement must encompass a dimension of tax avoidance. South African courts have interpreted the definition of an arrangement widely which aids in advancing the remedy of the Commissioner and aligns with the spirit and purport of the GAAR itself (Pidduck, 2017:78). This is evident in the case of *Meyerowitz v Commissioner for Inland Revenue* (1963) 4 All SA 148 (A) where Beyers, JA of the Appellate Division, agreed with the logic applied by Watermeyer J, in the *court a quo* when in interpreting the term 'transaction, operation or scheme', he stated that '… the word "scheme" is a wide term and I think there can be little doubt that is sufficiently wide to cover a series of transactions…' (*Meyerowitz v Commissioner for Inland Revenue* (1963) 4 All SA 148 (A) at 155).

De Koker and Williams (2019:par.19.36) are of the view that an arrangement includes all kinds of concerted action through which persons arrange their affairs for the purpose of obtaining a particular outcome. In line with this, it is important to note that the anti-avoidance provisions of the Act can be applied to the avoidance arrangement as a whole or to the individual steps within the arrangement (Section 80H of the Act). The intention behind the GAAR's application to individual steps in an arrangement is to prevent taxpayers from inserting steps which provide tax savings effects into a larger arrangement which demonstrates a non-tax purpose (Pidduck, 2021).

3.2.1.2. Tax benefit

The presence of an impermissible avoidance arrangement is dependent on the existence of a 'tax benefit' as defined in the Act as follows:

- 'Tax' is defined in Section 80L of the Act to include any tax levy or duty imposed by the Act (that if the Income Tax Act 58 of 1962 which will include, for example, Donations tax and Dividends Withholding tax) or any other Act administered by the Commissioner (e.g. Estate Duty Act 45 of 1955).
- 'Tax benefit' is defined in Section 1(1) of the Act to include 'any avoidance, postponement, or reduction of any liability for tax'.

Pidduck (2017:80) aptly states that this term could be interpreted to include a wide range of ordinary and legitimate transactions undertaken by the taxpayer in day-to-day business, in an effort to reduce his or her tax liability, and that this was not the intention of the legislature. In light of the broad scope afforded by the definition of 'tax benefit', South African courts have been forced to interpret the term in order to clarify its seemingly wide interpretation for purposes of applying the GAAR.

In *Commissioner for Inland Revenue v King* (1947) 2 All SA 155 (A) at 160, Watermeyer CJ clarifies that the liability for payment of any tax, levy or duty sought to be avoided or reduced for purposes of applying the GAAR is not a liability which has accrued or already exists, since such liability cannot be avoided *per se*, but is rather an *anticipated liability* for tax for the current or future years of assessment. Along these lines, Corbett JA in the Appellate Division case of *Commissioner for Inland Revenue v Louw* (1983) 2 All SA 291 (A) at 307 concurred with his learned judge colleagues in *Smith v Commissioner for Inland Revenue* 1964 (1) SA 324 (A) at 333 and *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A) at 492 in stating that the meaning of avoiding liability for tax purposes means to 'get out of the way of, escape or prevent anticipated liability'. The courts have also established the so-called "but for" test to be applied in determining whether a transaction had the effect of avoiding tax by asking the question as to whether 'the taxpayer would have suffered tax but for the transaction?' (*Income Tax Case* No 1625 59 SATC 383 at 396-397; Pidduck, 2017:81).

Considering the principles laid down in the *dicta* above, the question as to whether a 'tax benefit' arises from a particular arrangement will depend on:

- The existence of an anticipated liability for tax (*Commissioner for Inland Revenue v King* (1947) 2 All SA 155 (A)).
- Whether the taxpayer has effectively escaped anticipated liability which has resulted in a tax benefit (*Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A)).
- Whether the taxpayer would have suffered tax <u>but for</u> entering into or carrying out steps in the arrangement. In determining whether a tax benefit exists, the courts apply the 'but for' test, which centres around the question 'would the taxpayer have suffered tax but for the transaction?' (*Income Tax Case* No 1625 59 SATC 383).

3.2.1.3. Sole or main purpose

The 'sole or main purpose' requirement in Section 80A was inherited from the previous GAAR, which was contained in Section 103(1) of the Act (Pidduck, 2021). It reads as follows in the Act:

'An avoidance arrangement is an impermissible avoidance arrangement if its *<u>sole or main purpose</u>* *was to obtain a tax benefit and…'* (emphasis added).

From the reading of the opening words of Section 80A it is evident that the 'sole or main purpose' requirement is a *sine qua non* for an 'impermissible avoidance arrangement', meaning that transactions which lack such a purpose, irrespective of whether the transaction gave rise to a tax benefit, will mean that the GAAR will not apply to that transaction (De Koker and Williams, 2021:par.19.38). A rebuttable presumption is contained in Section 80G of the Act which stipulates that the onus rests squarely on the party obtaining the benefit to prove that obtaining the benefit was not the sole or main purpose of the avoidance arrangement. In *SBI v Lourens Erasmus (Edms) Bpk* 1996 (4) SA 344 (A) the court interpreted the word 'mainly' in isolation and held that it refers to a quantitative measure of more than fifty % (*SBI v Lourens Erasmus (Edms) Bpk* 1996 (4) SA 344 (A)).

Section 80G creates a presumption that the sole or main purpose of the transaction is to obtain a tax benefit, therefore, the burden of proof rests on the party obtaining the benefit to prove that the sole or main purpose was not the avoidance of tax and requires that the person adequately discharge this onus through affirmative or conclusive evidence which is satisfactory to a court on a balance of probabilities (De Koker and Williams, 2021:par.19.38; Pidduck, 2019:82). The evidence furnished is 'reasonably considered in light of the relevant facts and circumstances' against the assertion that obtaining a tax benefit was not the sole or main purpose of the arrangement (Pidduck, 2019:82). No guidance concerning the words 'reasonably considered in light of relevant facts and circumstances' is provided in Section 80G(1) and therefore it is unclear on what is encompassed by 'the relevant facts and circumstances' to rebut the presumption (De Koker and Williams, 2021:par.19.38).

De Koker and Williams (2021:par.19.38) hold the view that the concept of 'purpose' in the context of the GAAR is determined objectively and not subjectively as case law has historically found (e.g. Corbett, JA in *Secretary for Inland Revenue v Gallagher* (1978) 3 All SA 1 (A) at 5 in stating that "… in my view, the test is undoubtedly a subjective one"). This means that according to the authors, the inquiry into the sole or main purpose of an arrangement is not determined by looking at the subjective purpose of the parties to the arrangement, but rather the objective purpose of the arrangement itself and whether the objective effect of the arrangement resulted in a tax benefit. One can deduce that from this reasoning, the motives or intentions of the parties *vis-à-vis* the arrangement are arguably irrelevant for purposes of the sole or main purpose of the arrangement.

3.2.1.4. The tainted element requirements

An avoidance arrangement must contain at least one of the tainted elements in order for it to be subject to the GAAR (Pidduck, 2017:84). Section 80A divides an 'impermissible avoidance arrangement' into three contexts, namely an avoidance arrangement entered in the context of business (Section 80A(a) of the Act), in a context other than business (Section 80A(b) of the Act), and in any context (Section 80A(c) of the Act). The tainted elements are necessary elements to the extent that the requisite sole or main purpose is present, in other words, the mere presence of one or more of the elements is not an indication of the existence of a sole or main purpose, and an 'impermissible avoidance arrangement' can only be said to come into existence when one of the tainted elements is present in addition to the requisite sole or main purpose (De Koker and Williams, 2021:par.19.39).

For the purposes of this study, 'impermissible avoidance arrangements' in a *non-business* context will be considered as contained in Section 80A(b) and not the tainted elements contained in Section 80A(a)(i)-(ii), namely, '*bona fide* business purpose' and 'lack of commercial substance', which deal with arrangements which take place in the context of business.

Section 80A(b) states that 'in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit'. In contrast to arrangements set 'in the context of business', there is no need to inquire into whether there is a 'lack of commercial substance' (De Koker and Williams, 2021:par.19.39). Any arrangement which occurs in a non-business context must also clear the statutory hurdle envisaged in Section 80A(c) which deals with arrangements 'in any context,' whereby an arrangement must not have 'created rights and obligations that would not normally be created between persons dealing at arm's length' as well as the absence of misuse and abuse of the provisions of the Act which pertains to avoidance arrangements which frustrate, manipulate or exploit the purpose of any of the provisions of the Act and which result in outcomes not intended by the legislator.

Element 1: Abnormality of the means and manner in which the arrangement was entered into or carried out (Section 80A(b)).

According to Section 80A(b) of the Act, an avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and:

'in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a *bona fide* purpose, other than obtaining a tax benefit' (emphasis added).

'The Section 80A(b) provision speaks of a '*bona fide* purpose' which presumably requires that the taxpayer adopt a methodology when transacting that aligns with the achievement of a personal, family or charitable goal, as long as the goal is not to obtain a tax benefit (De Koker and Williams, 2021:par.19.39). The use of the words 'would not normally be employed' suggests that the test is to compare the actual arrangement with an objective hypothetical scenario that is considered 'normal' to both the means and manner in which the arrangement was entered into and carried out. Unfortunately, the term 'abnormality' is not defined in the Act and since no case law interpreting this tainted element of the GAAR has been adjudicated since inception of the GAAR, there is still much uncertainty regarding its meaning (Pidduck, 2017:85).

By inference, if the method employed qualifies as a method that one would normally employ for a *bona fide* purpose, then the fact that a tax benefit was obtained does not trigger the GAAR unless another tainted element is present (Section 80A(a)-(c) of the Act; De Koker and Williams, 2021:par.19.39). The test of abnormality is problematic for several reasons since what is considered as 'abnormal' at one point in time might have over time developed into common practice through commercial acceptability and norms (De Koker and Williams, 2021:par.19.39).

Interestingly, there is no presumption of abnormality, unlike the presumption placed on the taxpayer to prove on a balance of probabilities that the sole or main purpose of entering or carrying out the arrangement was not to obtain a tax benefit (Section 80G of the Act; De Koker and Williams, 2021:par.19.39). Instead, the onus of proving that an arrangement is abnormal in a non-business context rests on the Commissioner as held in the seminal case of *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* (1999) JOL 5363 (A) where the Supreme Court confirmed that the onus rests on the Commissioner to prove the existence of abnormality in a transaction in stating that:

*'… it is not necessary to deal with the Special Court's findings that the abnormality of the transactions had not been established. Suffice it to say that what the Commissioner had to establish, was the **<u>abnormality</u>** of the transaction as sales and leasebacks*' (emphasis added).

Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd) (1999) JOL 5363 (A) at page 15 Paragraph 16.

De Koker and Williams (2021:par.19.39) submit that the reference to a 'bona fide purpose' in Section 80A(b) is ambiguous and poorly drafted, since what the legislature intended was to ascertain whether the method utilised by the taxpayer was *bona fide* and viewed objectively as not attempting to obtain a tax benefit.

<u>Element 2: 'Rights and obligations that would not normally be created between persons at arm's length' (Section 80A(c)(i)).</u>

An avoidance arrangement is an impermissible avoidance arrangement if the sole or main purpose of the arrangement was to obtain a tax benefit and:

'(c) in any context –

(i) It has <u>created rights and obligations</u> that would <u>not normally be created between persons dealing at arm's length</u>; or

(ii) *It would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).'* (emphasis added).

Section 80A(c)(i)of the Act.

It is clear that the words 'in any context' mean that Section 80A(c) applies to any arrangement conducted in a business or non-business context and therefore any avoidance arrangement which falls short of adhering to these criteria will be deemed impermissible (De Koker and Williams, 2021:par.19.39).

In the Appellate Division in *Commissioner for Inland Revenue v Louw* (1983) 2 All SA 291 (A) at 302 Corbett JA applied the logic set out by Trollop JA in *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A), and discussed the application of the arm's length principle where the parties in the set of facts were partners and therefore not dealing at arm's length:

'… should the Court, in applying the "normality" yardstick, take account of the special relationship between the erstwhile partners and the company which they have formed, or ignore it and apply the yardstick as though the company were a stranger? I do not see how the Court can ignore this special relationship and yet give proper effect to the concluding words of s 103 (1) (ii), viz

"under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question..." (My italics). For it is of the very nature of the incorporation scheme that the company to which the practice is sold by the partners will have as its shareholders and directors the self-same partners and will be controlled by them. Those are the realities of the situation' (emphasis added).

The *Louw* decision provides insight into situations where a special relationship exists between parties to an arrangement, and that testing whether the rights and obligations of the parties are abnormal can only be conducted by asking whether in the context of that type of special relationship each party sought to "…extract from the transaction the best possible advantage for himself" (*Commissioner for Inland Revenue v Louw* (1983) 2 All SA 291 (A) at 302).

Element 3: Misuse or abuse of the provisions of the Act (Section 80A(c)(ii)).

Section 80A(c)(ii) of the Act states that an avoidance arrangement is an impermissible avoidance arrangement if the sole or main purpose of the arrangement was to obtain a tax benefit and:

'(c) in any context –

(i) It has created rights and obligations that would not normally be created between persons dealing at arm's length; or

(ii) It would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part)'

The introduction of this tainted element in the South African GAAR was a quest to bring the GAAR in line with international standards and was drawn from the Canadian GAAR, found in Section 245 of the Canadian Income Tax Act RSC 1985, C. 1 (5^{th} Supp). Distinctively, the Canadian GAAR provides the misuse and abuse element in Section 245(4) of the Canadian Income Tax Act in its negative, by stating that the GAAR *fails* to apply where a transaction would *not* result in a misuse or abuse of the provisions of the Canadian GAAR legislation (Pidduck, 2017:101). The intentions behind the legislators of the South African GAAR and the Canadian GAAR are synonymous, namely to determine whether the purpose of the arrangement was to exploit, frustrate or manipulate the legislation on which the taxpayer relied and this resulted in a outcome which was not intended by the legislators (Pidduck, 2017:101).

The Canadian GAAR makes use of the double negative for purposes of application of the third tainted element, whilst the South African GAAR adopts a positive application (Pidduck, 2017:157). The difference between adopting a negative application as opposed to a positive application of the element means that the Canadian GAAR is construed in its operation and *does not apply* to transactions which *would not result* in a misuse or abuse of the Act (Pidduck, 2017:101). A positive test as required in the South African GAAR, means that *any misuse or abuse* of the Act will invoke the misuse and abuse element of the GAAR without regard to the purpose of the arrangement (Pidduck, 2017:100).

The Bill of Rights has influenced South African courts to move away from a literal interpretive approach to a purposive approach when analysing and speaking on the law pertaining to a particular set of facts (De Koker and Williams, 2021:par.19.39). The Constitution enshrined in Section 39 of the Bill of Rights the principle that when interpreting the Bill of Rights, a court, tribunal or forum must consider international law and may consider foreign law, and further, in Section 39(2) that 'every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights'. It is settled law that statutory interpretation should be in accordance with the promotion of the general legislative purpose that the statutory provision aims to achieve (De Koker and Williams, 2021:par.19.39).

3.3. The *ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) judgment in the context of the GAAR

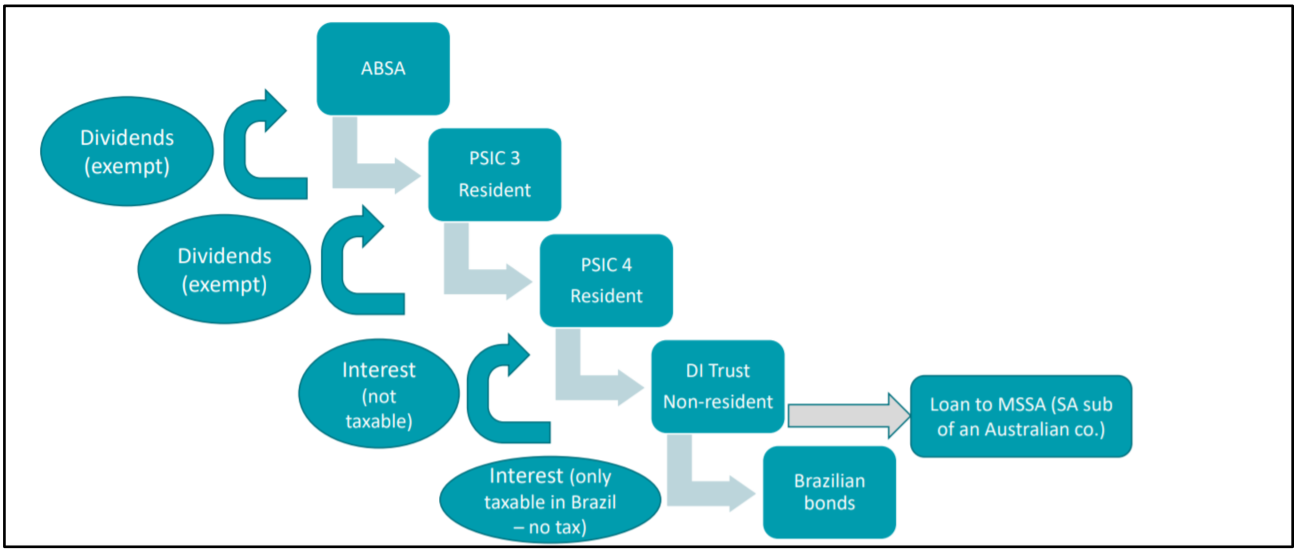
The South African GAAR contained in Section 80A–80L of the Act was enacted in 2006 and came into force on 2 November 2006. The first judgment regarding the interpretation of the GAAR was held in 2021 in the High Court of Gauteng in *ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) (hereafter the "*ABSA*" case). According to Pidduck (2021), the *ABSA* case dealt with a judicial review application of the actions taken by SARS in invoking the GAAR. It is an important judgment for purposes of this study, since it provides insights into the interpretation of the provisions of the GAAR which has not been interpreted since enactment, such as the understanding of the words 'arrangement', 'scheme' and 'party to' such arrangement.

3.3.1. The facts

The *ABSA* case dealt with an application sought by the applicant to review a refusal by the respondent to withdraw a Section 80J notice and consequent letters of assessment in respect of tax liability imposed by Section 80B of the Act. The applicant invoked Section 9 of the Tax Administration Act 28 of 2011 demanding a withdrawal of the Section 80J notice, however the respondent did not comply with the request. The origin of the dispute was the assertion by the respondent that the transactions entered into by the applicant constituted impermissible avoidance arrangements. The purported impermissible avoidance arrangements pertaining to the *ABSA* case are summarised below (*ABSA Bank Limited and* *another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 10-15):

- The applicant, ABSA Bank Limited, and its wholly owned subsidiary ABSA Towers (Pty) Ltd, bought tranches of preference shares in a South African Company, PSIC 3, held for periods during the tax years 2014 to 2018. The purchase of these shares entitled the applicant to dividends when declared by PSIC 3.
- PSIC 3 bought preference shares in another company, PSIC 4.
- PSIC 4 invested in an offshore trust, DI Trust, and this trust lent money to a South African company, MSSA. MSSA was a subsidiary of a group of companies domiciled in Australia, namely the Macquarie Group.
- DI Trust made investments by way of the purchase of Brazilian government bonds in respect of which interest income was received by DI Trust.
- In essence, PSIC 4 received interest on its capital investment in DI Trust, as a result of which PSIC 4 could declare a dividend to PSIC 3 and PSIC 3 could subsequently declare a dividend to ABSA. Since the dividend was declared between two South African resident companies, it was free of dividends withholding tax.

Figure 6: A summary of the facts pertaining to the ABSA Bank Limited and another v Commissioner, South African Revenue Service 2021 JDR 0403 (GP) case.



Source: The Tax Faculty Monthly Tax Update April 2021

3.3.2. Questions before the court

The questions that the court was tasked with answering were (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 9):

3.3.2.1. Is the applicant, ABSA, a 'party' to an impermissible avoidance arrangement in terms of the GAAR?

3.3.2.2. Did ABSA procure a tax benefit as contemplated by the GAAR?

3.3.3. SARS' view

Stemming from the Brazilian investment by DI Trust, SARS was of the view that a tax avoidance arrangement had been constructed which resulted in PSIC 4 declaring a dividend to PSIC 3 and in turn, PSIC 3 declaring a dividend to ABSA, and since the dividend was declared between two South African companies, ABSA received a tax-free dividend. Through the unravelling of the series of transactions it was clear to SARS that ABSA was a 'party' so defined in Section 80L of the Act to an impermissible avoidance arrangement. SARS contended that the lawful result of these series of transactions ought to have been the receipt of interest income to ABSA, which would attract tax and not the receipt of a tax-free dividend (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 16).

3.3.4. ABSA's view

The argument by ABSA was premised on the fact that ABSA had acted in a state of ignorance since it was their understanding that PSIC 3 and MSSA had a back-to-back relationship and that the funds would flow directly to MSSA to repay debt to its parent company, the Macquarie Group. According to ABSA, it was unaware of the intervention between PSIC 4 and the DI Trust, and DI Trust's Brazilian transaction. ABSA maintained that it did not bear a tax avoidance motive in entering and carrying out the transaction nor did it procure a tax benefit to which it was not duly entitled (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 17).

3.3.5. High Court Judgment

Issue 1: Was ABSA a 'party to' an 'impermissible arrangement'?

SARS, as the respondent, was of the view that ABSA, as the applicant, was a party to the impermissible avoidance arrangement. The court held that the definition of 'party' in Section 80L requires the taxpayer to 'participate or take part' in an arrangement, which requires volition on the part of the taxpayer which means that the taxpayer ought to participate in the arrangement and not merely be present in it. To this end, Sutherland ADJP held that the fact that a taxpayer may be the recipient of a benefit derived from an impermissible avoidance arrangement does not mean that the taxpayer participated or took part in the arrangement (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 39).

SARS contended that an 'arrangement' was present in which ABSA was a party thereto. However, according to the court, SARS failed to show that ABSA was anything more than an investor, and that there was no basis to support the notion that ABSA's investment in PSIC 3 was motivated by an intention to obtain a tax benefit from an anticipated tax liability. In addition, for an 'arrangement' to exist, several transactions need to be unified in order to formulate a deliberate chain, and the mere series of subsequential events does not constitute a chain (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 39-41).

Issue 2: Did ABSA receive a tax benefit in terms of Section 80A?

The court dealt with this issue succinctly and held that the 'but for' test is relevant for purposes of assessing whether tax liability was evaded with respect to future anticipated tax liability, and in the set of facts under consideration it had to be determined, but for the purchase of preference shares by ABSA in PSIC 3, how would anticipated tax liability be evaded by ABSA? To this end, the court held that no foundation was set by SARS to demonstrate how tax liability was to be evaded by ABSA (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 42-

43). In conclusion, it was held that the Section 80J notice should be withdrawn and the subsequent assessment be set aside, since ABSA was not a party to an impermissible avoidance arrangement, nor did it have the intention to escape an anticipated tax liability (*ABSA Bank Limited and another v Commissioner, South African Revenue Service* 2021 JDR 0403 (GP) at Paragraph 44-51).

3.3.6. Implications of the judgment

It is unfortunate that Sutherland ADJP did not discuss and interpret the meaning of all of the requirements contained in Section 80A of the Act, such as the 'sole or main purpose' criterion and the three tainted elements. In the ABSA case, the interpretation of the GAAR was limited to a discussion and analysis on the 'arrangement' criterion and the 'tax benefit' criterion. The relevant principles enunciated by the court in the ABSA judgment can be summarised as follows (The Tax Faculty Monthly Update, 2021; PWC, 2021):

- An 'arrangement' consists of the unification of a series of transactions which form a deliberate chain and does not consist of a series of transactions in chronological order without a golden thread which runs through the chain.
- A person is not considered a 'party to' an 'arrangement' if they are a party to a single transaction.
- The avoidance of tax is a subjective enquiry which requires an answer to whether a person would have incurred a liability to tax 'but for' entering into or carrying out an arrangement.
- The case opens up opportunities for taxpayers to assert that ignorance and wilful blindness prevented them from 'knowing' that they had contributed to a step in the larger transaction which is the subject of an enquiry.

CHAPTER 4: THE DUAL RESIDENT DILEMMA – WILL A PERMANENT HOME BREAK THE TIE?

4.1. INTRODUCTION

The focus of this chapter is on the specific actions taken by South African expats to invoke the DTA tie-breaker clause, in an effort to cease tax residence in South Africa, and whether these actions will trigger application of the South African GAAR. So far, the study has elaborated on the concept of ordinarily resident and its connection to Section 10(1)(o)(ii) of the Act in Chapter 2, as well as an interpretation and analysis of the requirements contained in the GAAR in Chapter 3. In this chapter, different scenarios based on real life examples will be tested against each requirement of the GAAR to determine whether the GAAR could be triggered.

The scenarios outlined in this chapter were derived from practical examples identified by emigration tax expert, Hugo van Zyl, owner of the private tax practice 'Wegkaner,' as well as literature and related reading material on the topic of expat tax and its developments in the cross-border space. These scenarios represent current real-life examples specific to South African expats, working for employers in the UAE, who find themselves in a dual resident dilemma.

These scenarios will be applied to Lucy, the proxy taxpayer described in Chapter 1. Lucy is assumed to earn a salary of more than R1.25 million per annum from a foreign employer in the UAE. She is a tax resident of the UAE, which is proven by way of a tax residency certificate issued by the UAE Tax Authorities. Although living and working in the UAE, she remains ordinarily resident in South Africa. This also makes Lucy a tax resident of South Africa and therefore, she will be taxed on a worldwide basis in South Africa. The only assets owned by her in South Africa are cash, her previous primary residence and personal use assets. She meets all of the requirements of the Section 10(1)(o)(ii) exemption and is therefore entitled to exempt the first R1.25 million of her foreign employment income for South African tax purposes. She visits South Africa once a year for a month-long holiday.
A crucial starting point for this study is the assumption that the South African expat remains ordinarily resident in South Africa and can break tax residency through the application of a DTA tie-breaker clause. Thereafter, the study focuses on understanding the principles and

requirements contained in the GAAR, in order to assess whether its application in the expat scenarios would be warranted. The requirements of the GAAR, namely the arrangement, tax benefit, sole or main purpose, and the three tainted elements will be analysed in this chapter against the backdrop of certain scenarios outlined below.

4.2. INVOKING THE PERMANENT HOME CRITERION IN THE DTA TIE-BREAKER CLAUSE BY SOUTH AFRICAN EXPATS

The reader should recall the body of literature compiled in Chapter 2 regarding the domestic law stance of 'ordinary residency' for South African tax purposes, coupled with the fact that Lucy is considered a 'resident' in the UAE, as per the tax residency certificate issued for the 2021 year of assessment. The residence of a taxpayer is determined in accordance with the domestic law of the relevant state. Article 4(1)(a) of the SA/UAE DTA stipulates that for the purposes of applying the agreement, the term 'resident of a Contracting State' means, in terms of South African law, any person who is *liable to tax* by reason of that person's domicile, residence, place of effective management, or any other criterion of a similar nature. Applying this to the set of facts, Lucy is considered liable to tax in South Africa, since she is still ordinarily resident here. Lucy is liable to tax on her worldwide income, including the foreign remuneration earned abroad to which Section 10(1)(o)(ii) of the Act will apply.

In the UAE, the term 'resident of a Contracting State' for purposes of the DTA means any individual who is considered a resident of the UAE by reason of that individual's domicile, *residence*, place of effective management or any other criterion of a similar nature (Article 4(1)(b)(i) of the DTA between the UAE and South Africa). Lucy is also considered resident in the UAE since a residency certificate was issued to her by the UAE tax authorities. Therefore, it is clear that Lucy is liable to taxation in both countries.

An individual who complies with Article 4(1)(a) and Article 4(1)(b)(i) of the SA/UAE DTA is considered 'dual resident' (i.e. two countries simultaneously classify an individual as 'resident' for tax purposes). The application of Article 4(2) of the DTA is then triggered, otherwise known as the DTA tie-breaker clause, which assists when tax residency conflicts arise. The aim of a treaty tie-breaker clause is to allocate residency to one of the Contracting States only. The individual is treated as a resident solely of one State for purposes of the DTA, which aims to limit the taxing right of one Contracting State over the right of the other

Contracting State. Assuming that Lucy takes active steps to ensure that the application of the tie-breaker clause will result in her being regarded as a resident of the UAE by applying the permanent residence test, the effect of invoking the DTA tie-breaker clause in the SA/UAE DTA means that the UAE is awarded sole taxing rights with regard to Lucy's employment income earned in the UAE. However, Lucy would not actually pay tax on her employment income in the UAE since the UAE does not levy personal income tax on employment income.

As a break in South African tax residency will take place, the importance thereof must be recalled in the context of this study. It means that the application of Section 10(1)(o)(ii) of the Act with regard to the expat's foreign remuneration is irrelevant, as Lucy will not be taxed in South Africa on the foreign remuneration income at all. Therefore, no amount of foreign employment remuneration will be included in her gross income to which the exemption would have applied. Furthermore, no capital gains tax will be triggered under Section 9H of the Act in Lucy's case, since she only possesses immovable property in South Africa which does not result in a deemed disposal. Lucy is therefore taxed neither in the UAE nor in South Africa. This double non-taxation scenario brings about the question as to whether this arrangement (and the steps purposefully undertaken by Lucy) constitutes an impermissible avoidance arrangement for purposes of the GAAR.

For purposes of this study, the fist factor of the tie-breaker clause contained in Article 4(2) of the DTA, is considered, namely:

'[That] where by reason of the provisions of Paragraph 1 of the Article <u>an individual is a resident of both Contracting States</u>, then that individual's status shall be determined as follows:

> *(a) <u>the individual shall be deemed to be a resident only of the State in which a permanent home is available to the individual</u>; if a permanent home is available to the individual in both States, the individual shall be deemed to be a resident only of the State with which the individual's personal and economic relations are closer (centre of vital interests)'* (emphasis added).

The tie-breaker clause takes into consideration different factors in order of preference to assign the residency of a dual resident individual to a single state (Tax Consulting, 2019:91). The inquiry stops when a factor is considered conclusive in deciphering the state which is allocated taxing rights over the individual (Tax Consulting, 2019:91). Importantly, although the residence of a taxpayer is determined in accordance with domestic law as per Article 4(1), the permanent home of a dual resident is determined autonomously through the interpretation of terms *outside* domestic law and in accordance with the object and purpose of the treaty tie-breaker clause (Resch, 2019). Should Lucy seek to apply the SA/UAE DTA tie-breaker test, she must be able to provide evidence to SARS that she is in fact a tax resident of the UAE through the provision of a certificate of tax residence issued by the Ministry of Finance of the UAE (Tax Consulting, 2019:92). In addition, she needs to ensure that she continues to have a permanent home in the UAE, only, and not in South Africa.

4.2.1. Application

<u>Scenario 1:</u> Lucy and Jamie sell their residential home in Pretoria. In the UAE, Lucy and Jamie stay in a hotel for a period of 6.5 months before purchasing a house in Dubai.

The residential home in South Africa (before disposal): Prior to the sale of Lucy and Jamie's immovable property in South Africa, it constituted a single permanent home to them. This home was permanent in nature and available to Lucy continuously and without interruption since no renting out of the house occurred.

The hotel stay in the UAE: The disposal of the house in South Africa could be indicative of Lucy and Jamie's desire to make a 'clean-break' and to leave South Africa permanently. However, it is assumed that Lucy remains ordinarily resident in South Africa. Post-sale of the house in South Africa and prior to the acquisition of the house in Dubai, Lucy effectively had no permanent home available to her in either South Africa or the UAE. The temporary stay in a hotel is not regarded as a permanent home since it is not available to Lucy on a continuous basis, it is only available to her for a specified short duration of time. According to the OECD's Commentary on Article 4 in instances where an individual has no permanent home available to them in either Contracting State, preference is given to the Contracting State where the individual has a *habitual abode* (Paragraph 16 of the OECD's Commentary on Article 4). Since the habitual abode criterion is concerned with the frequency, duration and regularity of the stays which are part of a settled routine of an individual's life, the UAE would qualify as the habitual abode for Lucy since it is in the UAE where Lucy habitually stays for 6.5 months. It is also the country where she has established a settled routine and where she is customarily present (Paragraph 19 of the OECD's Commentary on Article 4).

Acquiring the residential home in Dubai: The acquisition of the immovable property in Dubai established a permanent home for Lucy since the house is available to her on a continuous basis. Since Lucy disposed of her residential home in South Africa, she only has one permanent home available to her and it is situated in the UAE.

The existence of one permanent home in either Contracting State to an agreement easily answers the 'permanent home' requirement of a tie-breaker clause. Interestingly, when no permanent home exists in neither of the Contracting States, the question turns to the State where the taxpayer's habitual abode can be identified. A temporary stay of short duration in a hotel does not constitute a permanent home.

<u>*Scenario 2:*</u> Lucy and Jamie retain ownership of their residential house in Pretoria and let it out to a person, who is not a related person, at an arm's length price and on arm's length terms for a period of two years.

Paragraph 13 of the OECD's Commentary on Article 4 expressly states that:

'…a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an <u>unrelated party</u> so that the individual no longer has the possession of the house and the possibility to stay there' (emphasis added).

The term 'unrelated party' is not defined in the OECD Commentary on Article 4, nor is it defined in Article 3 of the SA/UAE DTA. Article 3(2) of the SA/UAE DTA states that any term not defined in the agreement shall have the meaning that it has at that time under the law of the state imposing the taxes to which the agreement applies. Therefore, since South Africa is imposing taxation on Lucy's foreign remuneration income, the domestic law of South Africa must be utilised to interpret the term (Paragraph 13.1. of the OECD's Commentary on Article 3). Although the Act does not define the terms 'related' or 'unrelated' it contains a definition for the term 'relative' in Section 1 of the Act and is defined as:

'in relation to any person, means the spouse of that person or anybody related to that person or that person's spouse within the third degree of consanguinity, or any spouse of anybody so related, and

for the purpose of determining the relationship between any child referred to in the definition of "child" in this section and any other person, that child shall be deemed to be related to the adoptive parent of that child within the first degree of consanguinity' (emphasis added).

Therefore, for purposes of Scenario 2, the letting out of Lucy's residential house in South Africa does not relate to a lessee who is a 'relative', by definition, of Lucy's or a relative of her spouse, Jamie. The reader should recall the facts of the *Interpretative Decision ATO* ID 2012/93 where the taxpayer, an Australian homeowner, contracted with his employer to work in Malaysia for a period of two years. The taxpayer anticipated that on completion of the two-year period in Malaysia, he would return to his home in Western Australia. Prior to leaving for Malaysia, the taxpayer entered into a two-year lease agreement with another person for the same period of time that he expected to be in Malaysia, where it was agreed that the lessee would have the exclusive right of quiet and enjoyment of the property during the lease period.

The ATO analysed the term 'permanent home available to him' contained in Article 4(2)(a) of the DTA between Australian and Malaysia, and held that the taxpayer was not able to occupy his home at any time during the lease period, based on the rights of the lessee in terms of the lease agreement. This made the taxpayer's home *unavailable* to him for the period of the lease and consequently did not constitute a permanent home for the period of the lease.

Based on the above reasoning, it is clear that due to the lessee's use of Lucy's residential property under a lease agreement, the permanent home criterion fails since the house is not available to Lucy and Jamie at all times continuously, for the two-year lease period. They are not capable of using the home for at least two years, since they are bound by the terms in the lease agreement, therefore, the notion of 'permanence', essential to first order factor of the tie-breaker in Article 4(2) of the SA/UAE DTA, is not satisfied. No permanent home exists for Lucy in South Africa under this scenario. If the residential home in South Africa remained unoccupied then it could be considered as readily available to Lucy at any time which would mean that she had a permanent home in both South Africa and the UAE.

Scenario 3: Lucy and Jamie retain ownership of their residential house in Pretoria and let it out to Lucy's sister, Jenny, at a non-arm's length price for the 2021 year of assessment. The house has two bedrooms. It was considered common practice in the 2021 year of assessment for individuals to let out their homes to relatives at a non-arm's length price during the COVID-19 pandemic, on account of the financial pressures exacerbated by the pandemic, as well as the uncertainties around the restriction on movement of people cross-border. It is also common for relatives of taxpayers to choose to rather incur the expenditure of maintaining the property in lieu of fixed rental payments each month. Lucy and Jamie preferred to have their home rented out to a relative or close friend, instead of a stranger, so as to ensure that it would be well looked after and maintained to their liking. After having occupied the house for a full year, Jenny can no longer afford to pay the rent for the particular premises due to financial pressures brought about by COVID-19, and cancels via written notice two months before expiration of the lease period. Due to the sluggish state of the estate industry brought on by the COVID-19 pandemic, Lucy is struggling to find a new tenant for 2022.

The OECD Commentary on Article 4 is silent on instances where a house owned by an individual is rented out and effectively handed over to a related party. It simply states in Paragraph 13 of the OECD's Commentary on Article 4 that:

'…a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an <u>unrelated party</u> so that the individual no longer has the possession of the house and the possibility to stay there' (emphasis added).

It is not clear whether Paragraph 13 can be interpreted in the inverse, namely if the house is let to a related party, and whether it would still constitute a permanent home. If tested against the definition of 'relative' in Section 1 of the Act, Jenny is indeed a 'relative' as defined, since she is a related to Lucy within the third degree of consanguinity. However, it is not clear how much emphasis should be placed on the following terms and phrases and how they should be interpreted: 'to be available', 'handed over', 'no longer has possession', 'possibility to stay there'. A few interpretations come to mind when analysing the terms and phrases contained in Paragraph 13 of the OECD's Commentary on Article 4, namely:

'to be available':

- Should the entire area of the house be available or is there a minimum area availability threshold? Otherwise stated, would one, two, or three rooms in a house be sufficient to meet the availability requirement?
- Would a house used primarily for furniture storage fulfil the 'to be available' requirement?
- If a house is listed on the property market in a quest to obtain tenants, is it considered 'available' to the taxpayer?
- Would illegal squatters occupying the taxpayer's property render it unavailable to the taxpayer?

'handed over' and 'no longer has possession':

- Do the above phrases pertain to a physical handover of the keys to the property?
- If the taxpayer is allowed to enter the property without permission, would it still be considered as available to him or her?

'possibility to stay there':

- What is the difference here between a guest having the option to stay at the taxpayer's home and the taxpayer's possibility to stay at the home? Is this a question of a degree of possibilities?

The OECD Commentary on Article 4 is silent on a number of concepts, terms and phrases to which the permanent home criterion relates. There is a plethora of real-life examples where a home may or may not be available to the taxpayer and it is uncertain as to how the OECD MTC 2017 and its Commentary attempt to deal with these examples in practice.

Jenny's 12 month stay at Lucy's house: Despite the length of Jenny's stay (a full year) in Lucy's residential home in South Africa during the 2021 year, the house could still be interpreted as being available to Lucy at any time during this period due to the relationship between Lucy and Jenny. By inference, if Lucy rents out her home in Pretoria to immediate family, she would not be considered to have given up her home for the duration of her absence in the UAE (Tax Consulting South Africa, 2019:93). However, it is also possible to argue that practically, the house was *not available* to Lucy during the 2021 year of assessment at any time due to the following salient reasons:

- Due to the COVID-19 pandemic, the UAE closed its borders for the majority of the 2021 year and disallowed South African travellers from entering into the country for the remainder of the year due to the rising number of COVID-19 cases in the country;
- Assume Jenny and her husband welcomed twins to their family during the 2021 year of assessment. The twins were given the second bedroom in Lucy's house. With both bedrooms being occupied by Jenny and her husband in one and their children in the other, the residential house in South Africa was ill-equipped to accommodate Lucy and her family, should she have decided to return to South Africa. This places the question of *continuous availability* of the house to Lucy's disposal in question.

Jenny's termination of the lease agreement and the two-month vacancy: It is questionable whether in this scenario the two-month unoccupancy renders automatic availability of the house to Lucy. If it were to be applied strictly and the house would be deemed available to Lucy, would she be able to prove that since the house is ill-equipped to cater for the size of her family, it should not be considered as available to her for example? Or in circumstances where a lessee fails to perform in terms of a lease agreement (such as Jenny) and is effectively in breach, that this automatically triggers the existence of a permanent home to the taxpayer due to the fact that suddenly the home is 'available' to him or her? The debate as to whether a house is or isn't available to a taxpayer, in scenarios such as these, within the ambit of the permanent home criterion, has not been interpreted by foreign nor domestic courts, and as such, there is no guideline to follow when applying it practically. It is uncertain how broadly the availability of a permanent home should be interpreted; however, it can be presumed that a court will take into account the particular facts and circumstances of a taxpayer's case.

Regarding the termination of the lease agreement, as illustrated in the ATO's *Interpretative Decision* ID 2012/93, the lessee's right of occupancy could not be terminated unless there is a breach of the term in the lease agreement or the lease period expires. In general, lease agreements terminate on the expiration date agreed on by the parties to the agreement or when cancelled by notice in the event of breach, death or insolvency. In South African law, Section 14 of the Consumer Protection Act 68 of 2008, applying to natural persons in fixed-term lease agreements, stipulates that consumers (either the landlord or tenant) may cancel the agreement at any time by providing the twenty business days' written notice of such cancellation. Jenny, Lucy's sister, is within the ambit of the law in South Africa with regard to terminating the lease early.

It is submitted that the strict interpretation of the permanent home criterion housed in Article 4(2)(a) of the OECD MTC 2017 should not lead to absurdities or anomalies which would not have been contemplated by the OECD. A purposive approach should be followed in interpreting the existence of a permanent home in light of the specific facts and circumstances surrounding the taxpayer. Should Lucy be found to have retained a permanent home in South Africa in addition to her permanent home in the UAE, then Lucy's residency for purposes of the SA/UAE DTA turns to the question of in which country her 'centre of vital interests' is present.

4.3. CLOSING REMARKS ON THE PERMANENT HOME CRITERION

Scenarios One to Three indicate that in some instances, identifying whether or not a taxpayer has a permanent home in one of the Contracting States may prove to be cumbersome for both the tax authorities of the country in which the (alleged) permanent home is located and the taxpayer. The lack of judicial precedent on the interpretation of terms and phrases contained in tie-breaker clauses and the OECD's Commentary of the MTC adds to taxpayer uncertainty on how to manage their affairs in cross-border situations. Table 2 provides a summary of how the permanent home criterion discussed above is applied in relation to the SA/UAE DTA.

Table 2: A summary of the permanent home criterion and its application contained in Article 4(2) of the SA/UAE DTA

Application of ‘Permanent home’ criterion of tie-breaker clause	**Has a permanent home in South Africa**	**No permanent home In South Africa**
Has a permanent home in UAE	Consider ‘centre of vital interests’ criterion	Deemed exclusive UAE tax resident
No permanent home in UAE	Deemed exclusive South African tax resident	Consider ‘habitual abode’ criterion*

Source: Own design

*The ‘centre of vital interests’ criterion is skipped in the instance where no permanent home is available to the individual in either Contracting State, since the ‘centre of vital interests’ criterion hinges on the requirement that a permanent home exists in both Contracting States.

4.4. THE SOUTH AFRICAN GAAR

This section of the study focuses on the application of the South African GAAR to Lucy, the South African expat. For the purposes of this analysis, it is assumed that Lucy has successfully broken tax residency in South Africa through the application of Article 4(2)(a) of the SA/UAE DTA, namely the permanent home criterion. This act of breaking tax residency in South Africa will now be tested against the operation of the GAAR.

4.4.1. Arrangement

An arrangement is widely defined and includes a transaction, operation or scheme in terms of Section 80L of the Act (*Meyerowitz v Commissioner for Inland Revenue* (1963) 25 SATC 287 (A) at 300). There is no doubt that an arrangement exists, since the actions taken by Lucy to assert residence in the UAE consist of transactions, operations or schemes within the meaning of Section 80L of the Act.

4.4.2. Tax benefit

The presence of a tax benefit derived from the arrangement, regardless of the amount, is critical in determining whether an impermissible avoidance arrangement exists as defined in Section 80A of the Act (Pidduck, 2017:79). In accordance with Section 1 of the Act, a tax benefit includes the avoidance, postponement or reduction of any liability for tax. As held in *Commissioner for Inland Revenue v King* (1947) 14 SATC 184 (A) and *Smith v Commissioner for Inland Revenue* (26 SATC 1), a tax benefit is obtained by getting out of the way, escaping or preventing an anticipated tax liability. It could be interpreted that Lucy has effectively obtained a tax benefit due to the following facts:

- The SA/UAE DTA awards sole taxing rights to the UAE. The UAE does not levy personal income tax on the income of individuals working in the UAE. No tax returns are required to be filed either (Deloitte, 2021).
- Should Lucy have been deemed exclusively resident in South Africa for purposes of the SA/UAE DTA, she would have been taxed in South Arica on a worldwide basis. As from 1 March 2020, she would have been subject to tax (‘expat tax’) on her excess remuneration earned in the UAE, namely exceeding the R1.25 million exemption contained in Section 10(1)(o)(ii). The act of invoking the permanent home criterion contained in Article 4(2) of the SA/UAE DTA enables Lucy to escape tax on her excess foreign remuneration altogether, with no need to make use of the exemption. This constitutes a tax benefit as envisaged in the South African GAAR, which is one of the criteria necessary for application of the GAAR.

4.4.3. Sole or main purpose

Once an avoidance arrangement resulting in a tax benefit has been identified, the arrangement can only be successfully attacked by the South African GAAR if the sole or main purpose of the arrangement was to obtain a tax benefit (Pidduck, 2017:82). In terms of Section 80G of the Act, there is a presumption of purpose if a tax benefit is obtained. Therefore, the onus rests upon Lucy to prove that the sole or main purpose of the arrangement was not to obtain a tax benefit on a balance of probabilities.

SARS Interpretation Note 3 (Issue 2) provides guidance on what factors would persuade SARS to consider Lucy as ordinarily resident in South Africa (SARS Interpretation Note 3, 2018). The inverse is also true in that Lucy can prove that she does not meet the criteria necessary to be deemed ordinarily resident in South Africa since:

- She does not intend to be ordinarily resident in South Africa;
- Her fixed and settled place of residence is in the UAE;
- Her habitual abode, the place where she stays most often, her present habits and mode of life are in the UAE;
- Her family, employment and personal interests are located in the UAE; and
- Her children's schooling is located in the UAE.

The following documentation may assist Lucy in disclosing her burden of proof that she has ceased tax residency in South Africa for the 2021 year of assessment:

- A certificate of tax residence issued by the Ministry of Finance in the UAE for the 2021 year of assessment.
- A certified copy of the title deed of the property purchased in Dubai, proving that she is the rightful owner of the property and providing details on the location and purchase price of the property.
- Details of the sale of Lucy's residential home in Pretoria, South Africa, through a deed of sale agreement proving the transfer of ownership from Lucy to the buyer.
- A certified copy of the employment contract signed between Lucy and her employer in the UAE stipulating the address of where Lucy carries out her services and the period to which this applies.

Should Lucy not succeed in proving that her actions taken to cease ordinary residence in South Africa were not to obtain a tax benefit, then the question turns on whether one of the tainted elements is present in the transaction, operation or scheme for it to constitute an impermissible avoidance arrangement. Lucy will need to prove on a balance of probabilities that the ceasing of her tax residency in South Africa was not motivated by a tax benefit (Section 80G of the Act). In particular, Lucy would need to make out a case which is stronger than the Commissioner's by providing evidence that the sole or main purpose for ceasing residency (which refers to a quantitative measure of more than 50%) was *not* to obtain a tax benefit which may be difficult to quantify and prove (*SBI v Lourens Erasmus (Edms) Bpk* 1996 (4) SA 344 (A)).

4.4.4. Tainted elements

The final requirement contained in Section 80A of the GAAR is that at least one of the so-called tainted elements must be present in order for the GAAR to be invoked. The onus of proving that one of these tainted elements is present lies with the Commissioner. Sections 80C-80F of the Act contain guidelines and definitions that the Commissioner may rely on to discharge this onus, with reference to transactions undertaken in a business context which falls outside the scope of this study. For a transaction undertaken in a non-business context, one of the following elements must be present:

4.4.4.1. Means and manner

When interpreting the means and manner tainted element, an arrangement should be compared to a 'normal' transaction entered into for a consideration other than a tax benefit, and the question to be asked is: 'Is there a difference between the means and manner in which this transaction was entered into by the taxpayer, and a transaction entered into for *bona fide* purposes in the absence of a tax consideration?' It is submitted that the act of emigrating from a country on account of career opportunities, a diminished confidence in government, deficiency in the social structure of a society with regard to crime, healthcare, and education, increases in tax rates for a taxpayer base already overburdened by taxes, and a junk status economy, are not unique or abnormal grounds for emigration in a present-day South African context.

These push factors are not driven by the need to avoid or escape an anticipated or existing tax liability, and asserting that a 'tax benefit' should be interrupted widely so as to include these emigration factors would result in absurdities and anomalies, as then by inference, any decision to emigrate could be construed as amounting to avoiding taxation. Retaining ownership of a permanent home and leasing or renting it out to relatives at a reduced rate is not considered 'abnormal' in light of the COVID-19 pandemic. Transactions of this nature have become popular and commercially acceptable amongst people due to the effects of the pandemic, namely the restriction of peoples' movements, the threat of financial and job security, and the issue of finding tenants in 'good standing'. Therefore, it is submitted that the Commissioner may find it difficult to prove this tainted element in asserting that a transaction constitutes an impermissible avoidance arrangement.

Furthermore, the fact that a number of taxpayers rely on the treaty tie-breaker clause, such as Article 4(2) of the SA/UAE DTA, to break tax residency in a country like South Africa, and therefore escape the claws of expat tax, is indicative of a practice that has become common and therefore normal, not abnormal as required by this element (Sawy, 2019). It should be noted that the act of invoking the treaty tie-breaker clause in a DTA is not an automatic event when a taxpayer is considered dual resident for purposes of a DTA. On the contrary, an expat taxpayer is required to take the active step in invoking the tie-breaker, by notifying the Commissioner of his or her intention to do so (Tax Consulting South Africa, 2019:92-93).

4.4.4.2. Rights or obligations not normally created

This tainted element has been interpreted to mean that since each of the parties to the arrangement are independent of each other, in dealing with one another they will strive to obtain the 'utmost possible advantage' out of the transaction for themselves (*Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A) at 16). Thomson CJ in *Hicklin v Secretary for Inland Revenue* (1980) 1 All SA 301 (A) at 120 interpreted the term 'arm's length' in the context of rights and obligations as what unrelated and unconnected persons would have agreed on in the same or similar situation. Transactions amongst unconnected, independent persons at market value are illustrative of arrangements concluded at arm's length (Pidduck, 2017:98).

In order to consider the rights and obligations derived from an arrangement, it is necessary to take cognisance of the various parties involved in the transaction under analysis. To this end, the parties to the arrangement are Lucy, as expat and taxpayer, SARS as the party invoking the South African GAAR, and Lucy's employer domiciled in the UAE. After analysing all of the interrelations amongst the involved parties, the following remarks can be made regarding the rights and obligations which might not normally have been created between persons dealing at arm's length:

- Invoking the treaty tie-breaker clause in the SA/UAE DTA enabled Lucy to be deemed exclusively resident in the UAE for purposes of application of the DTA. In transactions, operations or schemes occurring outside the context of business, it may be increasingly difficult to ascertain an arm's length price, especially in dealings with relatives. There is nothing 'abnormal' about breaking tax residency. The consequence of breaking tax residency is the avoidance of expat tax, and this has already been identified as a resultant tax benefit. Lucy is one of an estimated 20,000 to 60,000 South African expats living in the UAE, based on South African embassy figures, meaning that her actions do not create abnormal rights and obligations, since many South Africans are ceasing residency through this means (Sawy, 2019).
- Any resident that ceases tax residency will only be taxed on a source basis in South Africa, therefore no abnormal rights have been created for Lucy at the expense of the Commissioner.
- Lucy's UAE employer: The employment contract governs the employment relationship between Lucy and her employer, it does not create rights and obligations to Lucy's employer other than the benefit of having Lucy employed full-time at the employment premises in the UAE. Lucy is paid a salary in exchange for services rendered which constitutes a 'normal' and standard employer-employee contract at an arm's length.

In light of the uncertainties around how an arm's length price will be determined in a non-business context, it is submitted that the Commissioner will find it difficult to prove that abnormal rights and obligations flowed to an expat from the ceasing of tax residency through the treaty tie-breaker clause.

4.4.4.3. Misuse and abuse

According to Pidduck (2017:101), the intention of the legislation must be understood in order to ascertain whether the purpose of the arrangement was to exploit, frustrate or manipulate it, and that the expat taxpayer relied on its application resulting in an outcome not aligned with the legislator's intention. The Canadian GAAR provides the misuse and abuse element in its negative by stating that the GAAR *fails* to apply where a transaction would *not* result in a misuse or abuse of the provisions of the Canadian GAAR legislation (Pidduck, 2017:101). The Canadian GAAR makes use of the double negative for purposes of application of the third tainted element, whilst the South African GAAR adopts a positive application (Pidduck, 2017: 157). The difference between adopting a negative application as opposed to a positive application of the element means that the Canadian GAAR is construed in its operation and *does not apply* to transactions which *would not result* in a misuse or abuse of the Act (Pidduck, 2017: 101). A positive test as required in the South African GAAR, means that *any misuse or abuse* of the Act will invoke the misuse and abuse element of the GAAR without regard to the purpose of the arrangement (Pidduck, 2017:100).

South African expats relying on the SA/UAE DTA tie-breaker clause contained in Article 4(2) to break tax residency in South Africa to be deemed exclusively tax resident in the UAE are within the ambit of South African law, since the definition of "resident" in Section 1(1) of the Act specifically caters for instances where exclusive residency is determined through a treaty tie-breaker clause for purposes of application of that treaty. Therefore, if South African domestic law provides South Africans with a legal remedy for ceasing tax residency in the country (i.e. through application of the treaty tie-breaker clause in a DTA), then there is no misuse or abuse since no law prohibits a South African from ceasing residency.

4.5. CLOSING REMARKS ON THE GAAR

The South African GAAR may be successful in attacking arrangements where the sole or main purpose of the avoidance arrangement was to obtain a tax benefit and one of the three tainted elements were present, namely the means and manner of carrying out or entering into the arrangement is not considered 'normal', or the arrangement created rights and obligations which would not normally flow from transactions between independent parties at an arm's length, or the provisions of the Act were misused and abused to the extent that the arrangement frustrated, manipulated or exploited the provisions of the Act achieving a result contrary to the intention of the legislator.

The *ABSA Bank Limited and Another v Commissioner for the South African Revenue Service* (2019/21825) [2021] ZAGPPHC 127; 2021 (3) SA 513 (GP) (11 March 2021) case is the most recent judgment concerning the South African GAAR housed in Section 80A–80L. However not all of requirements of the GAAR were analysed, interpreted and applied to the set of facts in question, therefore there is an interpretation gap in the operation of the GAAR. This study identified current scenarios experienced by South African expats and their actions of breaking tax residency in South Africa against the backdrop of possible application of the South African GAAR. The expats decision to invoke the 'permanent home' criterion housed in Article 4(2) of the SA/UAE DTA does not trigger application of the South African GAAR, since none of the three tainted elements essential to the operation of the GAAR are present. Table 3 provides a summary of how the permanent home criterion of the tie-breaker clause contained in the SA/UAE DTA is tested against the South African GAAR.

Table 3: Results of application of the permanent home criterion against the South African GAAR

GAAR requirements	Satisfied	Not satisfied	Uncertain
Is there an arrangement?	✔		
Does the arrangement/operation/scheme result in a tax benefit?	✔		
Is the sole or main purpose to obtain the tax benefit so described?	✔		
Is one of the three tainted elements present?			
• Was the arrangement entered into in a manner not normal for *bona fide* purposes? Or		✕	
• Has the arrangement created rights and obligations that are not at arm's length? Or		✕	
• Is there misuse or abuse of provisions of the Act?		✕	
Can the South African GAAR be invoked to the permanent home test?		✕	

Source: Own design

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1. INTRODUCTION

The study sought to address whether certain actions taken by South African expats to ensure ceasing of tax residence in South Africa under the DTA tie-breaker clause, would trigger the South African GAAR. The study specifically looked at the permanent home criterion contained in Article 4(2)(a) of the SA/UAE DTA which is the first order proxy of the treaty tie-breaker clause.

This chapter summarises the findings of the study in relation to the said research objectives as stated in Chapter 1, makes recommendations for future research and concludes by demonstrating that a knowledge gap has been filled in relation to the Section 10(1)(o)(ii) partial exemption. It also points out how South African expats can successfully cease tax residence in South Africa by invoking the DTA tie-breaker, without the Commissioner being able to prove that the arrangement constitutes an impermissible avoidance arrangement.

5.2. RESEARCH OBJECTIVES

The following research objectives outlined in Chapter 1 were achieved:

5.2.1. To understand, describe, and identify the principles relating to ordinary resident, the Section 10(1)(o)(ii) exemption, as well as the DTA tie-breaker clause relating to 'permanent home.'

This objective was addressed in Chapter 2 and required an in-depth investigation into the South African domestic tax law requirements for qualification as a resident. The meaning of ordinarily resident, provided for in Paragraph (a)(i) of the definition of resident in Section 1 of the Act, was researched thoroughly in order to ascertain when individuals are ordinarily resident in South Africa and how they might cease to be a resident by applying the DTA tie-breaker clause. A South African expat who is considered a resident as defined is taxed on a worldwide basis, whilst non-residents are taxed on South African sourced income. This is relevant in understanding the application of Section 10(1)(o)(ii) of the Act, which provides a maximum exemption of R1.25 million against foreign renumeration earned by South African resident taxpayers under a contract of employment resulting in so-called 'expat tax' on the excess as from 1 March 2020.

The application of expat tax in South Africa depends on whether the resident has worked more than 183 calendar days during any 12-month period of which at least 60 days were continuous outside the Republic. Due to the COVID-19 pandemic, this number has reduced to 117 calendar days during any 12-month period, however the 60 continuous days requirement is still present. Importantly for purposes of this study, a South African expat may qualify as dual resident based on the definition of resident provided in a relevant DTA. The SA/UAE DTA was used as a proxy in this study. The treaty tie-breaker rules contained in Article 4(2) of the SA/UAE DTA are relevant for purposes of determining tax residence of a natural person for purposes of the DTA (Article 4(2) of the SA/UAE DTA; Article 4(2) of the OECD MTC)).

The permanent home criterion contained in the treaty tie-breaker clause of Article 4(2)(a) of the SA/UAE DTA was chosen, in order to determine the tax residence of a natural person who is considered dual resident in terms of Article 4(1) of the DTA. The essential element of this criterion is the *permanency* of the house or home *available to* the South African expat. The study elaborated on the circumstances where a taxpayer has retained ownership of a home in the residence state, however, it is not available to him or her on a continuous basis. An example of this is the instance where the permanent abode of a person is leased or rented out to an unrelated third-party during the duration of the person's absence. It is submitted that in instances where the permanent abode is leased or rented out to a related party, such as immediate family of the South African expat, the home is seen to be available to the expat at any given time.

If tax residence is determined to be the UAE due to application of the tie-breaker clause, residence in South Africa ceases and the expat is subject to possible capital gains tax (so-called exit charge) provided for in Section 9H of the Act. Since the employment income earned by the South Africa expat is not from a South African source, no tax liability arises in South Africa (except for rental on immovable property located in South Africa). The consequences of ceasing tax residence in South Africa were only discussed in relation to possible application of the South African GAAR.

5.2.2. To understand, describe, and identify the principles encompassed in the South African GAAR and its application.

The requirements of the South African GAAR contained in Section 80A–80L of the Act were discussed in Chapter 3. It was established that an arrangement is a tax avoidance arrangement if the sole or main purpose of the arrangement is to obtain a tax benefit and at least one of the tainted elements is present in the transaction, operation or scheme. In terms of arrangements conducted outside the context of business, tainted element seeks to address whether the sole or main purpose of the arrangement was to obtain a tax benefit and whether or not the means and manner in which this was conducted would not normally be employed for *bona fide* purposes other than obtaining a tax benefit. The second tainted element aims to establish whether rights and obligations were created which would not normally be created between persons dealing at arm’s length. Lastly, the third tainted element dealing with misuse or abuse of the provisions of the Act aims at identifying whether the purpose of the legislation was exploited and frustrated as a result of the arrangement.

5.2.3. To understand actions taken by South African tax residents to cease residency and so defeat the capping of Section 10(1)(o)(ii) in South Africa, specifically the first criterion of the ‘permanent home.’

Different scenarios concerning a fictitious taxpayer named Lucy were used to achieve this objective in the first part of Chapter 4. The study confirmed that in instances where an expat’s permanent home is leased out or rented out to an unrelated third-party, on the basis of a lease or rental agreement, the abode is not readily available to the expat during the period of the lease or rental agreement. In instances where the dwelling is leased out or rented out to a relative, such as an immediate family member of the expat, it would be difficult for the expat to prove that the abode is not available to him or her for continuous periods of time. Importantly, some uncertainty exists regarding the interpretation of terms and phrases used in the OECD MTC 2017, as well as in the OECD’s Commentary on Article 4, in particular the terms ‘available to’, ‘handed over’, ‘unrelated party’, ‘no longer has possession’, and ‘possibility to stay there’. If the expat falls foul of determining residency in a single contracting state through the use of the permanent home criterion (i.e. the expat has a permanent home in each of the contracting states), then the second criterion ‘centre of vital interests’ contained in the tie-breaker clause will be considered. If the expat does not have a permanent home in either of the Contracting States, the centre of vital interests criterion is skipped and the habitual abode criterion must be invoked to determine residency.

5.2.4. To apply the South African GAAR in instances where South African expats have taken actions to cease residency under the DTA.

In the last part of Chapter 4, the requirements contained in Section 80A–80L of the South African GAAR were applied to the fictional set of facts that was determined to be effective in the breaking of tax residency under the permanent home criterion in the SA/UAE DTA tie-breaker clause. The aim was to determine whether the actions taken to invoke the permanent home criterion in Article 4(2)(a) of the SA/UAE DTA would be inconsistent with the provisions of the GAAR.

Actions taken by South African expats to cease tax residence in South Africa may be attacked by the South African GAAR with regard to the fact that an arrangement exists in the form of a transaction, operation or scheme. Furthermore, if such an arrangement resulted in a tax benefit (avoiding expat tax) which is assumed to have been the sole or main purpose of the arrangement, it will be difficult for South African expats to prove on a balance of probabilities that the sole or main (more than 50%) purpose was not to avoid expat tax.

However, even if the expats are unable to disprove that avoidance of expat tax was their sole or main purpose, the Commissioner will not be able to prove that the means and manner in which the tie breaker clause was invoked have been abnormal. A South African expat is within the legal parameters of the Act and therefore the GAAR to cease tax residence in South Africa and therefore render application of Section 10(1)(o)(ii) null. The act of ceasing tax residence status does not conflict with the provisions of the GAAR, since the domestic legislation itself (Section 10(1)(o)(ii) in conjunction with Paragraph(a)(i) of the definition of resident in Section 1 of the Act) provides for this loophole.-This is so since many expats are ceasing tax residence through the application of the treaty tie-breaker clauses afforded in DTAs, which then makes the abnormality of the act fall away.

The Commissioner will also not be able to prove that these actions created rights and obligations that would normally not be created between persons dealing at arm's length. This is so as it is very difficult, if not impossible, to determine arm's length.

There is also no misuse or abuse of the Act, since the domestic legislation itself provides for this loophole, namely that the outcome of the treaty tie-breaker clause overrides the ordinarily resident and physical presence test.

The study therefore concludes that invoking the permanent home criterion and successfully proving residency through the permanency of a house, dwelling or abode in a single country other than South Africa, does not activate the South African GAAR, as the Commissioner will be unlikely to be able to prove the existence of any one of the three tainted elements.

5.2.5. To suggest remedies for South African residents to prevent the application of the South African GAAR.

Expats wishing to cease tax residency in South Africa are encouraged to preserve documentation which proves that the sole or main purpose of ceasing residency was not to obtain a tax benefit. To this end, the expat could furnish documentary evidence proving that he or she had difficulty in securing adequate employment in South Africa, whilst overseas the employment opportunities afforded proved to be more lucrative and may be coupled with added benefits such as social security, access to better healthcare and schooling for children, travel opportunities and lower crime rates. It is advisable that South African expats opt to sell their homes in South Africa instead of maintaining them in the country, since it will be burdensome on the expat to prove that the home does not constitute a permanent home, unless it is effectively leased or rented out to an unrelated party at an arm’s length price. Alternatively, should an expat wish to rent out their home in South Africa, they should rent it out to an unrelated party and ensure that a lease/rental agreement establishes the terms and conditions of the lease/rental. In this scenario, it is advisable that the expat register as a provisional taxpayer and declare the rental income.

Furthermore, expats are encouraged to obtain a tax residency certificate in their host country which ultimately proves to the Commissioner that the expat is considered a resident in the host country. Should expats wish to invoke the DTA tie-breaker clause afforded by a DTA, a declaration of this intention is required to be made to the Commissioner. Expats should obtain a tax opinion by an independent registered tax practitioner in terms of Section 223 of the TAA to keep on file, in order to provide the Commissioner with an objective opinion on the residency status of the expat which could add evidentiary weight. Lastly, expats should be aware of the capital gains consequences of ceasing residency in South Africa and weigh up whether the cost of ceasing tax residency outweighs the benefits.

5.3. RESEARCH QUESTION ANSWERED

The study has answered the question as to whether the application of treaty tie-breaker rules, namely the 'permanent home' criterion, by South African residents to defeat Section 10(1)(o)(ii) will trigger the South African GAAR? Each research objective set by the study was met with the finding that South African expats who cease tax residence in South Africa through application of the permanent home criterion contained in the treaty tie-breaker clause in the relevant DTA will not fall foul of the South African GAAR.

5.4. FUTURE RESEARCH

Future research could focus on the ways in which the Section 10(1)(o)(ii) partial exemption and/or other legislative incentives can be amended or created in order to keep South African expats within the tax net of the country, instead of driving them to break tax residence in the country. Research could also be conducted as to how the GAAR could be utilised more effectively in tax avoidance arrangements, in order to secure more tax revenue. Reverting to the limitations set by this study, research could also be conducted on the actions taken by juridical taxpayers to cease tax residency in South Africa, and whether the South African GAAR would be applicable to those actions. In addition, natural persons earning business profits or persons working for a South African employer but living and working abroad could be used as a focus group for the study.

Furthermore, instead of a tax free jurisdiction such as the UAE being used as a proxy DTA partner country of South Africa, future research could identify a tax jurisdiction which levies personal income tax on employment services rendered by employees in that country, and use that as a proxy country for research. Regarding the treaty tie-breaker clause, the remaining criteria of the clause could be analysed against a factual background like the one provided in the study. In the context of the South African GAAR contained in Section 80A–

80L of the Act, impermissible avoidance arrangements entered into or carried out in a business context could be used as the benchmark for testing whether actions taken by juridical persons which cease tax residency invoke the GAAR. Another interesting angle for research could be the weighing up of the exit tax levied on the expat on the day he or she becomes a non-resident for tax purposes in South Africa, and the decision to break tax residency. Lastly, the requirements of Section 10(1)(o)(ii) of the Act, specifically the ambit of the 'remuneration' requirement, could be critiqued, specifically in relation to the limit of fringe benefits covered by the requirement, and how an expat working abroad who obtains fringe benefits falling outside the ambit of the requirement, would be affected in South Africa.

5.5. FINAL REMARKS

South African expats wishing to cease South African tax residency through application of the treaty tie-breaker clause contained in Article 4(2) of the SA/UAE DTA are encouraged to preserve documentary evidence proving that the intention behind the arrangement of breaking ordinary residence status in South Africa does not equate to impermissible tax avoidance.

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APPENDIX A:

Declaration of plagiarism

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Students who are guilty of plagiarism will forfeit all credits for the work concerned. In addition, the matter will be referred to the Committee for Discipline (Students) for a ruling. Plagiarism is considered a serious violation of the University's regulations and may lead to your suspension from the University. The University's policy regarding plagiarism is available on the Internet at *http://www.library.up.ac.za/plagiarism/index.htm*.

For the period that you are a student at the Department of Taxation, the following declaration must accompany **all** written work that is submitted for evaluation. No written work will be accepted unless the declaration has been completed and is included in the particular assignment.

	Student
I (full names and surname):	Chloe Frances Molyneux
Student number:	12060276

Declare the following:

1. I understand what plagiarism entails and am aware of the University's policy in this regard.
2. I declare that this assignment is my own, original work. Where someone else's work was used (whether from a printed source, the Internet or any other source) due acknowledgement was given and reference was made according to departmental requirements.
3. I did not copy and paste any information directly from an electronic source (e.g., a web page, electronic journal article or CD ROM) into this document.
4. I did not make use of another student's previous work and submitted it as my own.
5. I did not allow and will not allow anyone to copy my work with the intention of presenting it as his/her own work.

CHLOE FRANCES MOLYNEUX

Signature

APPENDIX B:

LANGUAGE EDITING CERTIFICATE

UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

KNG LANGUAGE EDITING SERVICES
"Say It With Style"

K.N. Groenewald
22 Marais Street
Bailey's Muckleneuk
Pretoria
0181
0829366250

10 October 2021

To Whom It May Concern

CONFIRMATION OF LANGUAGE EDITING OF A MASTERS DISSERTATION:

Defeating Section 10(1)(o)(ii) of the Income Tax Act within the parameters of South Africa's General Anti-avoidance Rules

Herewith confirmation that the abovementioned dissertation, by Ms Chloe Molyneux, has been language edited.

Yours sincerely

K.N. Groenewald