THE TAX BASE OF SOUTH AFRICAN INDIVIDUALS:
AN INTERNATIONAL COMPARISON

by

R Stander
20130008

Submitted in partial fulfilment of the requirements for the degree

MCom in Taxation

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

Supervisor: Prof E. Venter

September 2013
ACKNOWLEDGEMENTS

I would like to extend my gratitude to the following:

- My Lord for the talent, strength and resolution He gave me
- My husband, Erich, for all his love, encouragement and support
- My family and friends for all their prayers and support
- My supervisor, Elmar, for his assistance and guidance during the study
- My language editor, Idette, for her assistance whilst finalising the study
ABSTRACT

THE TAX BASE OF SOUTH AFRICAN INDIVIDUALS: AN INTERNATIONAL COMPARISON

by R. Stander

SUPERVISOR: Prof E. Venter
DEPARTMENT: Taxation
DEGREE: Magister Commercii

South Africa changed its tax system from a source-based to a resident-based system in 2001. This change is in line with tax reforms worldwide. However, over the last two decades, personal income tax reforms have not resulted in a noticeable increase in tax revenue worldwide, even though governments find themselves hard-pressed to maintain or increase their expenditure.

The aim of this study was to compare the South African tax base, which relies on taxing individuals, with the tax base used in another developing country, namely India, as well as to those applied in two developed countries, namely the United Kingdom (UK) and the United States (US). This comparison identified similarities and differences between the countries, and highlighted possible improvements to South African tax legislation in order to broaden the country’s tax base and potentially increase tax revenues. For the purposes of the study, a tax base can be defined as the total income of an individual, after allowing for specified deductions, allowances and other adjustments, on which tax is levied.

It was determined that the tax base used in South Africa is similar in some respects to those used in India, the UK and the US. An improvement that South Africa could adopt is the inclusion of the annual value of house property, as
specified in the Indian tax system. The employment abroad exclusion from income could be replaced by a foreign-earned income exclusion, as applied in the US tax system. It was also determined that permitting certain deductions could in fact increase the tax base, as these deductions could entice taxpayers to register for tax, therefore increasing tax compliance and ultimately increasing tax revenue. By adopting any of the advantages of the other tax systems, South Africa can broaden its tax base and generate additional tax revenue to support the government’s needs.

KEY WORDS:
Tax base
Resident-based
Source-based
South Africa
India
United Kingdom
United States
OPSOMMING

DIE BELASTINGBASIS VIR SUID-AFRIKAANSE INDIVIDUE: ‘N INTERNASIONALE VERGELYKING

deur R. Stander

STUDIELEIER: Prof E Venter
DEPARTEMENT: Belasting
GRAAD: Magister Commercii

Die Suid-Afrikaanse inkomstebelastingstelsel het gedurende 2001 verander vanaf ‘n brongebaseerde stelsel na ‘n inwonergebaseerde stelsel. Hierdie verskuiwing is in pas met belastinghervormings dwarsoor die wêreld. Alhoewel persoonlike inkomstebelasting oor die laaste twee dekades hervorm is, het dit nie ‘n merkbare vermeerdering van staatsinkomste wêreldwyd tot gevolg gehad nie, maar regerings bly onder druk om hul uitgawes te handhaaf of te vergroot.

Die doel van die studie was om die Suid-Afrikaanse belastingbasis, wat berus op die heffing van belasting op individue, te vergelyk met dié wat in ‘n ander ontwikkelende land, naamlik Indië, toegepas word, sowel as met dié van twee ontwikkelde lande, naamlik die Verenigde Koningkryk en die Verenigde State. Die vergelyking het ooreenkomste en verskille tussen die onderskeie lande uitgelig, en het moontlike verbeteringe uitgewys wat die Suid-Afrikaanse inkomstebelasting-stelsel kan aanneem om sodoende die land se belastingbasis te vergroot en ‘n potensiële toename in belastinginkomste te bewerkstellig. Vir die doel van die studie, kan ‘n belastingbasis gedefinieer word as die totale inkomste verdien deur ‘n individu, nadat uitsluitings en aftrekkings in ag geneem is.

Daar is bevind dat Suid-Afrika se belastingbasis verskeie ooreenkomste met dié van Indië, die Verenigde Koningkryk en die Verenigde State toon. ‘n Verbe-
tering wat Suid-Afrika moontlik kan oorweeg is die insluiting van 'n jaarlikse waardebepaling op huiseienaarskap, soos van toepassing in die Indiese belastingstelsel. Die uitsluiting van die vergoeding van 'n buitelandse werknemer kan moontlik vervang word deur die beperkte uitsluiting van buitelandse inkomste soos in die Verenigde State se stelsel. Daar is ook bevind dat die toelating van sekere aftrekkings die belastingbasis inderdaad kan bevoordeel, omdat dit individue sal aanmoedig om te registreer as belastingbetaalers om sodoende te kwalifiseer vir die aftrekkings. Dit sal nakoming van belastingverpligtinge verhoog, en uiteraard ook die land se belastinginkomste vermeerder. Deur die voordele van ander lande se belastingstelsels in te span, kan Suid-Afrika sy belastingbasis verbreed en so addisionele belastinginkomste genereer wat die regering se behoeftes kan ondersteun.

**SLEUTELWOORDE:**

Belastingbasis
Inwonergerbaseerd
Brongerbaseerd
Suid-Afrika
Indië
Verenigde Koningkryk
Verenigde State
# CONTENTS

Acknowledgements ........................................................................................................... i  
Abstract ......................................................................................................................... ii  
Key words....................................................................................................................... iii  
Opsomming ....................................................................................................................... iv  
Sleutelwoorde................................................................................................................... v  

CHAPTER 1: INTRODUCTION.................................................................................. 1  
1.1 BACKGROUND .......................................................................................... 1  
1.2 PROBLEM STATEMENT ........................................................................ 2  
1.3 PURPOSE STATEMENT ......................................................................... 2  
1.4 RESEARCH OBJECTIVES / RESEARCH QUESTIONS ............................. 4  
1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY .......... 4  

CHAPTER 2: DELIMITATIONS AND ASSUMPTIONS .................................. 5  
2.1 DELIMITATIONS ................................................................................... 5  
2.2 ASSUMPTIONS ....................................................................................... 5  

CHAPTER 3: DEFINITION OF KEY TERMS ............................................. 6  

CHAPTER 4: LITERATURE REVIEW......................................................... 9  
4.1 INTRODUCTION.................................................................................... 9  
4.2 SOUTH AFRICA .................................................................................. 9  
4.2.1 Key terms.......................................................................................... 10  
4.2.2 South Africa’s tax base system ...................................................... 13  
4.2.3 Review of tax revenue .................................................................. 16  
4.2.4 Summary .......................................................................................... 18  
4.3 INDIA ................................................................................................. 20  
4.3.1 Key terms.......................................................................................... 20  
4.3.2 India’s tax base system ................................................................. 22  
4.3.3 Summary .......................................................................................... 25
7.4 FUTURE RESEARCH ................................................................. 84

LIST OF REFERENCES ............................................................. 85

© University of Pretoria
LIST OF FIGURES

Figure 1: South Africa tax base summary ............................................................... 19
Figure 2: India tax base summary ..................................................................... 26
Figure 3: UK tax base summary ..................................................................... 41
Figure 4: US tax base summary ..................................................................... 50

LIST OF TABLES

Table 1: Abbreviations used in this document ..................................................... 7
Table 2: Tax revenue as a percentage of main revenue sources in South
Africa .............................................................................................................. 16
Table 3: Tax revenue as a percentage of GDP in South Africa ....................... 17
Table 4: Incidence of different taxpayers ......................................................... 24
Table 5: Summary of source rules for income of non-resident aliens ......... 48
Table 6: Comparison of key terms ..................................................................... 64
Table 7: Income comparison ............................................................................ 64
Table 8: Exempt income comparison ................................................................. 65
Table 9: Deductions comparison ..................................................................... 66
Table 10: Citizen, but not resident, ordinarily resident or domiciled .......... 67
Table 11: Citizen, resident, ordinarily resident but not domiciled ............... 68
Table 12: Citizen, resident but not ordinarily resident and not domiciled .... 68
Table 13: Citizen, resident, domiciled but not ordinarily resident ............. 69
Table 14: Non-citizen and non-resident .............................................................. 69
CHAPTER 1: INTRODUCTION

1.1 BACKGROUND

Governments across the world are hard-pressed to maintain or to increase their expenditure. In order to meet this demand, they need to make their tax systems more efficient and competitive (OECD, 2006:3). In many developing countries, the main reason for tax reforms is the necessity of increasing revenue to avert an approaching fiscal crisis (Rao, 2000:59). After observing tax reforms in many countries, Bird (cited in Rao & Rao, 2006:34) argues that “fiscal crisis has been proven to be the mother of tax reform”.

As a developing country, South Africa faces a vast challenge – there is an increase in the ongoing demand for government and public spending, which in turn needs to be funded by an increase in revenue derived from taxes (Steenekamp, 2012:48). Increasing the tax rate for individuals appears to be an obvious and simple solution; and there is already speculation that the wealthy in South Africa are likely be exposed to higher personal income tax rates in the near future (Ensor, 2013b). However, Poirson (2006:3) warns that “economic theory suggests that high tax rates may depress employment, investment, and growth”, and Steenekamp (2012:48) maintains that a reduction of personal income tax rates combined with the broadening of the tax base appears to be the best tax practice to cope with this revenue challenge.

The aim of this study is to determine whether the tax base in South Africa is geared towards individual taxpayers in order to satisfy the ever-increasing needs of the fiscus in an ever-changing global environment in the most efficient way. By comparing the tax base adopted in South Africa to that used in developed and other developing countries, possible improvements to the current tax base can be identified, which may in turn result in an improvement in the lives of all South Africans.
1.2 PROBLEM STATEMENT

South Africa changed its tax system from a source-based to a resident-based system in 2001 (SARS, 2012:9). Various macro- and micro-dynamics changed globally and locally, and the biggest factor was the global economic downturn in 2008. According to Steenekamp (2012:53), the personal income tax reforms over the last two decades have not resulted in an increase in South Africa’s tax revenue. More than half a decade ago, Nyamongo and Schoeman (2007:478) already stressed the importance of adopting a progressive tax system, but an extensive search of prior theses and dissertations, academic journals and books could identify no studies which put South Africa’s current tax base into perspective.

A recent newspaper article reported that Minister of Finance, Pravin Gordhan has initiated a vital review of South Africa’s tax system. A tax review committee will be appointed to evaluate South Africa’s tax system, compared to international standards and practices, as well as the latest international initiatives to advance tax compliance, and methods to deal with tax base erosion (Ensor, 2013a). This planned review highlights the fact that there has been no recent analysis of the South African tax base. The current study may therefore provide useful insights in this regard.

1.3 PURPOSE STATEMENT

The main purpose of this study is to compare South Africa’s basis for taxing individuals with that of another developing country, India. The study also aims to compare South Africa’s basis for taxing individuals to those of developed countries such as the United Kingdom (UK) and the Unites States (US). A comparison is done to highlight any similarities and differences, as well as identify potential improvements to broaden and protect the tax base.
The various countries were selected for the following reasons:

- **India**
  - India, like South Africa, is a developing country;
  - India and South Africa are both part of the Brazil, Russia, India, China and South Africa (BRICS) group of countries;
  - India is a member of the Commonwealth;
  - the tax liability in India for individuals depends on whether they are “resident and ordinarily resident”, “resident but not ordinarily resident” or “non-resident”; and
  - South Africa also applies the terms “resident” and “ordinarily resident”.

- **The UK**
  - the UK has one of the largest economies in the world and is a member of the G8;
  - the UK is a member of the Commonwealth;
  - for individuals, UK tax liability depends on whether the individual is a “resident”, an “ordinary resident” or is “domiciled” in the UK in the tax year; and
  - South Africa includes the terms “resident” and “ordinarily resident” in its tax system, but does not use the concept of being “domiciled” in the country as a criterion.

- **The US**
  - the US has the world’s largest economy and is a member of the G8;
  - when determining the tax liability for individuals, whether the individual is a “citizen”, “resident alien” or “non-resident alien” is taken into account; and
  - the main difference between South Africa and the US is that the term “citizen” forms part of the US tax base, but does not form part of South Africa’s tax base.
1.4 RESEARCH OBJECTIVES / RESEARCH QUESTIONS

The research objectives of the study are

- to identify the advantages and disadvantages of the four tax systems (South Africa, India, the UK and the US) that are compared; and
- to suggest improvements and changes to South African tax legislation.

1.5 IMPORTANCE AND BENEFITS OF THE PROPOSED STUDY

This study scrutinizes South African tax legislation that applies to taxing individuals in order to determine whether this legislation is still relevant enough to support the country’s financial sustainability.

The different tax base systems used in South Africa, India, the UK and the US are documented to obtain an understanding of these systems. Advantages and disadvantages of the various systems are identified and any similarities are highlighted. The study also emphasises possible improvements and strengths identified in the various tax systems abroad that can possibly be adopted in South Africa.

This study consists of seven chapters. The next chapter explains the delimitations and assumptions that apply to the proposed study, which is followed by a chapter which lists definitions of the key terms and abbreviations used in the study. The fourth chapter contains a discussion of the prior literature that identifies the tax systems in use for taxing individuals in South Africa, India, the UK and the US. The fifth chapter is a discussion of the research design and methods applied. The literature on the similarities and differences between the countries is discussed and compared in Chapter 6. The advantages and disadvantages of these tax systems are discussed in that chapter, and recommendations are made. The last chapter presents a conclusion and points the way forward for further research.
CHAPTER 2:
DELIMITATIONS AND ASSUMPTIONS

2.1 DELIMITATIONS

This study has the following delimitations:

- the study focuses only on the income tax base for individual tax payers (not companies) and does not cover any other form of taxation that might be evident or might become evident during the study;
- the influence of tax rates on the tax base is not considered;
- the comparison of income, exempt income and deductions in the results chapter is not exhaustive, but focuses only on typical income and expense items in relation to individuals;
- the detailed rules applicable to tax deductions are not evaluated;
- double tax agreements and their effects are not considered; and
- only the countries listed in the purpose statement are studied, namely South Africa, India, the UK and the US.

2.2 ASSUMPTIONS

An assumption is “a condition that is taken for granted, without which the research project would be pointless” (Leedy & Ormrod, 2012:5). Several basic assumptions underlie the proposed study. It is assumed that

- the terms “tax base”, “tax reform”, “emigrant” and “expatriate” have the same meaning in South Africa as in India, the UK and the US, although the term may be interpreted differently in these countries;
- the term “year of assessment” has the same meaning in South Africa, India, UK and the US, in other words, 12 months, although the month on which the year of assessment ends may differ; and
- the term “tax year” has the same meaning as “year of assessment”.

© University of Pretoria
CHAPTER 3:
DEFINITION OF KEY TERMS

This study employs a number of key terms. The meanings of these key concepts are considered below:

- **Assessment:**
  An assessment is the determination of a taxpayer’s tax liability (or refund) by the tax authority in respect of a specific year of assessment (SARS, 2012:25).

- **Expatriate:**
  This is a person who temporarily lives in a different country to his/her native country (InterNations, n.d.).

- **Residence minus:**
  Residents are taxed on their world-wide income, but specific categories of income and activities undertaken outside a country are exempt from tax in that country (SARS, 2000a:1).

- **Tax arbitrage:**
  This refers to arranging a person’s affairs to take advantage of different tax regimes in different jurisdictions. The aim is to achieve a reduction in the overall level of tax payable. So, for example, a person can obtain a deduction for interest where the corresponding receipt is not taxed, or is effectively not taxed due to the reliefs available (HM Revenue & Customs, n.d.(b)).

- **Tax base:**
  The tax base of a taxpayer refers to a person’s total income, after allowing for specified deductions, allowances and other adjustments, on which tax is levied (Income Tax Department, 2013).

- **Tax deducted at source:**
  This refers to the amount of tax deducted at source by the payer from the taxpayer’s accrued income (Singhania & Singhania, 2012:747).

- **Tax expenditure:**
  These are revenue losses attributable to tax relief in the form of special
exclusions, exemptions, deductions, credit, a preferential tax rate or a deferral of tax liability (Gravelle & Hungerford, 2012:3).

- **Tax reform:**
  This refers to a broad change of the tax system, rather than a fractional change in law (The Encyclopedia of Taxation and Tax, cited in Gravelle & Hungerford, 2012:1).

- **Year of assessment:**
  This is the year in which tax is liable,
  - under South African law, ending on 28/29 February, according to section 1 of the *Income Tax Act, No 58 of 1962* (South Africa, 1962);
  - under the Indian tax system, ending on 31 March, according to section 2(9) of the *Income Tax Act, 1961* (India, 1961);
  - under the UK tax system, ending on 5 April, according to section 4(3) of the *Income Tax Act, 2007* (UK, 2007); and
  - under the US tax system, either a calendar year ending on 31 December or the taxpayer's fiscal year, ending on the last day of any month except December (IRS, 2013d).

A number of abbreviations are used in this study. These are listed in Table 1, below.

**Table 1: Abbreviations used in this document**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>BRICS</td>
<td>Brazil, Russia, India, China and South Africa</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>HM Revenue &amp; Customs</td>
<td>Her Majesty’s Revenue and Customs</td>
</tr>
<tr>
<td>IRC</td>
<td>Internal Revenue Code, published as Title 26 under the United States Code</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>SARS</td>
<td>South African Revenue Service</td>
</tr>
<tr>
<td>SRT</td>
<td>Statutory Residence Test</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>USC</td>
<td>United States Code</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Meaning</td>
</tr>
<tr>
<td>--------------</td>
<td>------------------</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-added tax</td>
</tr>
</tbody>
</table>
CHAPTER 4:
LITERATURE REVIEW

4.1 INTRODUCTION

This study focuses on identifying and analysing the tax base employed in four countries, so it is imperative to understand the term “tax base”.

The tax base of a taxpayer can be defined as the total income of the individual taxpayer, after allowing for specified deductions, allowances and other adjustments, on which tax is levied (Income Tax Department, 2013). Therefore the tax base determines who is liable for income tax, what items are liable for income tax and what income tax rate is applied to these taxable items. This chapter examines which individuals are liable for income tax and on what items income tax is levied. As mentioned in the delimitations chapter, the influence of tax rates on the income tax base is not considered in the current study.

4.2 SOUTH AFRICA

Historically, South Africa followed a source-based system for taxing individuals. This meant that all income that originated in South Africa, as well as income deemed to originate in South Africa, was taxable in South Africa. No reference was made to residency in this method, apart from a few exceptions. However, since 1998 South Africa has gradually moved towards taxing residents on some part of their worldwide income (SARS, 2012:9). To broaden the tax base, further steps were taken on 1 January 2001 that resulted in South African residents’ being taxed on their worldwide income (except for certain exclusions/exemptions), and no longer just on income from a source or deemed source that originated in South Africa. With this transition, South Africa changed from a source-based system to a resident-based system (SARS, 2000a:1). Non-residents are still taxed on a source-based system (SARS, 2012:9).
No country has introduced a pure residence basis of taxation. Countries that apply a resident-based tax system have a system which is commonly referred to as a “residence-minus” system. The “minus” refers to exemptions from income tax, and the challenge is therefore to determine what this “minus” should be (SARS, 2000b:4). The main reasons for the transition from a source-based tax system to a resident-based tax system were to protect and broaden the tax base and align the South African tax system with international standards and principles (Nyamongo & Schoeman, 2007:481). Other reasons include the aim of placing South Africa’s tax system on a better footing, in the sense that the focus is placed on the exclusions from the tax base. It is essential to refine the tax base continuously, whenever deficiencies in the system are revealed (SARS, 2000b:4).

The most important change that resulted from the shift to a residence-based tax system in South Africa was the amendment of the gross income definition according to section 1 of the *Income Tax Act, No 58 of 1962* (South Africa, 1962) to reflect the worldwide base of taxation. In a worldwide tax system based on residency, it is essential that the term “residency” be accurately defined, because the magnitude of a taxpayer's tax liability depends on whether the individual is a resident or non-resident of South Africa (SARS, 2000a:1).

The remaining part of this chapter discusses the key terms affecting the tax base and the tax base applied in the South African tax system. A review of South Africa’s tax revenue is also discussed and a summary at the end of the chapter is provided to help identify a person’s tax base easily.

### 4.2.1 Key terms

The definition of a “resident” in section 1, paragraph (a) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962), is defined as a natural person who during a year of assessment is

- ordinarily resident in South Africa; or
- physically present in South Africa.
These terms are discussed in more detail below.

4.2.1.1 Ordinarily resident

The term “ordinarily resident” is not defined in the Income Tax Act, No 58 of 1962 (South Africa, 1962), and therefore South Africa relies on case law to enable an interpretation and understanding of the concept of the term “ordinarily resident”. Each case, in determining whether a person is ordinarily resident, the case must be decided on its own merits, with due consideration of the principles already established by case law and sources such as textbooks (SARS, 2002:2,4).

A person’s physical presence at all times is not mandatory for the person to be ordinarily resident. The two criteria that need to be met are, first, the person’s intention to become ordinarily resident in South Africa and, second, the person’s having taken steps confirming the intention of giving effect to this intention. The effect of this is that a natural person can be a resident of South Africa in a relevant year of assessment without being physically present in South Africa in that year, and the person’s circumstances as a whole should be examined. The purpose, nature and intention of his/her absence must be established to determine whether the person is still ordinarily resident (SARS, 2002:4).

In the case of Cohen v CIR, 1946 AD 174 (13 SATC 362), the court found that a person’s residence would be the country to which he/she would naturally and as a matter of course return from his/her wanderings. The principle in the above case was confirmed by CIR v Kuttel, 1992 (3) SA 242 (A) (54 SATC 298), where it was stated that a person can have more than one residence at a time, but that the words “ordinarily resident” have a different and narrower meaning – a person is ordinarily resident where he/she normally resides, apart from temporary or occasional absences.

Another aspect that should be taken into account to determine where a person is ordinarily resident is to identify “where in the settled routine of his[her] life he[her] regularly, normally or customarily lives” or “at which he[her] in mind and in fact settles into or maintains or centralises his[her] ordinary mode of living with
its accessories in social relations, interest and conveniences”. This principle was established in *Thompson v Minister of National Revenue*, 2 DTC 812 (SCC).

### 4.2.1.2 Physically present

An individual who is not “ordinarily resident” in South Africa can still be a resident of South Africa if the person meets the requirements of the “physical presence” test (Stiglingh, Koekemoer, Van Schalkwyk, Wilcocks & De Swardt., 2012: 51).

In terms of section 1 paragraph (a) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962), for an individual to be physically present in South Africa during a year of assessment, the person must be present in South Africa for a period or periods of

- more than 91 days in total during the current year of assessment;
- more than 91 days in total during each five years of assessment preceding the current year of assessment; and
- more than 915 days in total during the five years of assessment preceding the current year of assessment.

It should also be noted that where an individual has been classified as a resident based on the physically present test, the person becomes a non-resident if the person is physically outside South Africa for a continuous period of at least 330 full days (proviso (B) to par (a)(ii) of the definition of “resident” in section 1 of the *Income Tax Act, No 58 of 1962* (South Africa, 1962).

### 4.2.1.3 Non-resident

The term “non-resident” is not defined in the *Income Tax Act, No 58 of 1962* (South Africa, 1962), so it must first be determined whether a person is a resident. If the person does not comply with the resident requirements, the person is deemed to be non-resident in South Africa (Stiglingh *et al.*, 2012:58).
4.2.2 South Africa’s tax base system

South Africa has a residence-based income tax system, with the effect that a natural person defined as “resident” in terms of section 1 of the *Income Tax Act, No 58 of 1962* (South Africa, 1962) is subject to income tax on his/her worldwide income in South Africa, except for certain exclusions/exemptions (SARS, 2012:9). According to sections 1(a), (c), (e), (g), (k) of the definition of gross income and section 24J(3) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962), typical income categories (to name a few) that form part of a taxpayer’s worldwide income are

- amounts received in respect of services rendered (salaries, wages, bonuses, etc.);
- annuities;
- dividends (including foreign dividends);
- interest earned;
- rental income; and
- retirement fund lump sum benefits.

The exemptions (among others) referred to in the “residence-minus” system are

- alimony and maintenance;
- bursaries and scholarships;
- dividends (in general);
- employment abroad;
- interest (the first R 23 800 of interest earned if a person is younger than 65 years and R 34 500 if the person is older than 65 years); and
- unemployment insurance benefits.

(sections 10(1), (k), (mB), (o), (q) and (u) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962)).
Allowable deductions (to name a few) from a taxpayer’s worldwide income according to paragraph 2(4)(a)-(f) of the Fourth Schedule of the *Income Tax Act, No 58 of 1962* (South Africa, 1962) are

- pension fund contributions;
- retirement annuity contributions;
- medical aid contributions; and
- donations to approved public benefit organisations.

A taxpayer also has the advantage of the primary, secondary and tertiary rebates that can reduce his/her tax liability (section 6(2)(a)-(c) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962)).

In the case of a natural person who is a non-resident, the person is only liable for income tax on income from a source within (a true source) or deemed to be within South Africa (SARS, 2012:9). Income classified as income from a true source includes director’s fees earned where the company’s head office is located in South Africa and where the board of directors ordinarily transacts its business in South Africa (Stiglingh *et al*., 2012:65). In the case of interest earned on a loan, according to *CIR v Lever Brothers & Unilever Ltd* (1946 AD), the true source of interest earned on a loan is in South Africa if the supply of credit takes place in South Africa.

Dividends and interest are exempt from non-residents’ income, and deductions allowed are no different from those claimed as a deduction by a resident (SARS, 2012:30).

According to Bhorat, Meyer and Mlatsheni (cited in OECD, 2004:117), the international mobility of highly skilled workers has always been a sensitive issue in South Africa. The increase in economic globalization has created an increase in migrant workers. Unemployment and increasing poverty have encouraged many employees from developing countries to travel to other countries to find work. There is an estimated 175 million migrants around the world (ILO, 2013).
Due to the increase in migrant labour, it would seem sensible to consider how the residence-base tax system affects expatriates, secondees and emigrants.

Expatriate employees who work in South Africa on short-term contracts (between one and two years) are generally regarded as non-residents of South Africa, and therefore they are liable for income tax in South Africa only on a source basis. Therefore, the amounts earned from supplying this service are taxable in South Africa. However, if the expatriate’s contract of employment is extended for a longer period (to three to four years), the person risks being considered a resident of South Africa in terms of being ordinarily resident or complying with the physically present test. In this case, the expatriate is liable for income tax in South Africa on his/her worldwide income earned (SAICA, 2001).

If a South African employee is seconded to the foreign office of his/her employer, the remuneration earned from the services rendered outside South Africa are taxable according to the resident-based tax system. To alleviate the impact of these resident rules, the employee is able to claim an exemption in terms of section 10(1)(o)(ii) of the Income Tax Act, No 58 of 1962 (South Africa, 1962), provided that he/she complies with the required conditions: if the employee is outside South Africa for more than 183 full days in total during any period of 12 months and the employee is outside South Africa for a continuous period of 60 full days during these 12 months, the remuneration earned is exempt from income tax. This allows residents on short-term overseas secondments to avoid the risk of being taxed in two jurisdictions (SAICA, 2001).

Someone who formally emigrates from South Africa ceases to be ordinarily resident in South Africa. The physical presence test cannot be applied in the year of emigration, so, the person’s taxable income for the period from cessation of ordinarily residence to the assessment period (28/29 February) is not taxed on a worldwide basis. However, a practical problem may arise in the year after the person’s emigration if the resident has been present in South Africa for more than 183 days on average in the previous three years. This situation is likely to arise – therefore, to escape the physical presence test, the resident has to spend 91 days or fewer in South Africa in the first year after emigration (SAICA, 2001).
The ordinarily resident test is also applied to determine whether an immigrant is a resident of South Africa in the year of immigration. As with emigration, the physical presence test cannot be applied in the year a person immigrates (Stiglingh et al., 2012:60).

### 4.2.3 Review of tax revenue

Barreix and Roca (cited in Bird 2009:1) argue that the two central pillars of taxation in South Africa are income tax and value-added tax (VAT). Personal income tax is an important element for raising revenue on the one hand, and a key element for social cohesion on the other hand. However, Bird (2009:1) points out that, surprisingly, personal income tax revenues are relatively unimportant in many developing countries.

Tables 2 and 3 show South Africa’s current position regarding the contribution of personal income tax to total tax revenue and the gross domestic product (GDP).

**Table 2: Tax revenue as a percentage of main revenue sources in South Africa**

<table>
<thead>
<tr>
<th>Year</th>
<th>Personal income tax</th>
<th>Corporate income tax (CIT)</th>
<th>Secondary tax on companies (STC)</th>
<th>Value-added tax (VAT)</th>
<th>Fuel levy</th>
<th>Customs duties</th>
<th>Specific excise duties</th>
<th>Other</th>
<th>Total tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>31.2%</td>
<td>26.5%</td>
<td>3.2%</td>
<td>24.7%</td>
<td>4.0%</td>
<td>3.6%</td>
<td>3.2%</td>
<td>3.6%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2008/09</td>
<td>34.3%</td>
<td>22.5%</td>
<td>2.6%</td>
<td>24.7%</td>
<td>4.8%</td>
<td>3.3%</td>
<td>3.6%</td>
<td>4.3%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2009/10</td>
<td>33.7%</td>
<td>19.7%</td>
<td>2.5%</td>
<td>27.2%</td>
<td>5.1%</td>
<td>4.0%</td>
<td>3.4%</td>
<td>4.4%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2010/11</td>
<td>33.7%</td>
<td>20.4%</td>
<td>3.0%</td>
<td>25.7%</td>
<td>4.9%</td>
<td>4.6%</td>
<td>3.4%</td>
<td>4.2%</td>
<td>100.0%</td>
</tr>
<tr>
<td>2011/12</td>
<td>39.2%</td>
<td>13.4%</td>
<td>1.8%</td>
<td>24.7%</td>
<td>6.6%</td>
<td>3.7%</td>
<td>4.1%</td>
<td>6.4%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

*Source: Adapted from Department of National Treasury (2012).*
Table 3: Tax revenue as a percentage of GDP in South Africa

<table>
<thead>
<tr>
<th>Year</th>
<th>Personal income tax</th>
<th>Corporate income tax (CIT)</th>
<th>Secondary tax on companies (STC)</th>
<th>Value-added tax (VAT)</th>
<th>Fuel levy</th>
<th>Customs duties</th>
<th>Specific excise duties</th>
<th>Other</th>
<th>Total tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>8.5%</td>
<td>7.2%</td>
<td>0.9%</td>
<td>6.7%</td>
<td>1.1%</td>
<td>1.0%</td>
<td>0.9%</td>
<td>1.0%</td>
<td>27.1%</td>
</tr>
<tr>
<td>2008/09</td>
<td>8.4%</td>
<td>5.5%</td>
<td>0.6%</td>
<td>6.1%</td>
<td>1.2%</td>
<td>0.8%</td>
<td>0.9%</td>
<td>1.0%</td>
<td>24.5%</td>
</tr>
<tr>
<td>2009/10</td>
<td>8.2%</td>
<td>4.8%</td>
<td>0.6%</td>
<td>6.7%</td>
<td>1.3%</td>
<td>1.0%</td>
<td>0.8%</td>
<td>1.1%</td>
<td>24.5%</td>
</tr>
<tr>
<td>2010/11</td>
<td>8.3%</td>
<td>5.0%</td>
<td>0.7%</td>
<td>6.3%</td>
<td>1.2%</td>
<td>1.1%</td>
<td>0.8%</td>
<td>1.0%</td>
<td>24.6%</td>
</tr>
<tr>
<td>2011/12</td>
<td>9.1%</td>
<td>3.1%</td>
<td>0.4%</td>
<td>5.7%</td>
<td>1.5%</td>
<td>0.9%</td>
<td>1.0%</td>
<td>1.5%</td>
<td>23.2%</td>
</tr>
</tbody>
</table>

Source: Adapted from Department of National Treasury (2012).

As Tables 2 and 3 (above) show, in South Africa, personal income tax contributes more than 30% of the total tax revenue and makes up 8% of the total GDP. These statistics confirm the argument by Barreix and Roca (cited in Bird 2009:1) regarding the importance of personal income tax.

Personal income tax’s contribution to the country’s total tax revenue grew very little from 2001 to 2012, which supports Steenekamp’s (2012:53) claim that the personal income tax reforms over the last two decades have not resulted in an increase in tax revenue.

President Jacob Zuma confirmed that the government will be appointing a committee during the course of 2013 to investigate tax policy. He is of the opinion that the increase in tax revenue will reduce the budget deficit more rapidly (Blumenthal, 2013). However, Botha (cited in Blumenthal, 2013) argues that the current budget difficulties are due to the dissipation of funds, rather than to a shortage of funds. He also claims that the government will benefit more by broadening the tax base by increasing the efficiency of tax collection than by increasing tax rates.

South Africa may be able to benefit from comparing the tax base it uses to the tax bases used in India, the UK and the US. Any strengths of their systems could be considered and perhaps adopted by South Africa in order to improve personal
income tax's contribution to tax revenue, which may in turn assist in decreasing the budget deficit.

4.2.4 Summary

The way to determine the tax base for an individual taxpayer in terms of South African tax legislation is summarised by the algorithm generated in Figure 1, overleaf.
Consider the following

1. **Intention**
   Taxpayer must have the intention to become ordinarily resident.

2. **Steps**
   Steps confirming this intention have been carried out

---

**Ordinarily resident**

- Yes

**Physically present**

- No

---

**Resident**: Taxpayer is liable for tax on his **worldwide income**

---

**Non-resident**: Taxpayer is liable for tax on **income from source within or deemed to be within South Africa**.
4.3 INDIA

The key terms relevant to the tax base as well as the tax base that is applied in the Indian tax system are discussed below. At the end of the discussion, an algorithm is presented to determine an individual’s tax base easily.

4.3.1 Key terms

In India, tax is levied on the total income of the previous year (ending 31 March) (Income Tax Department, n.d.). According to section 3 of the Indian Income Tax Act, 1961 (India, 1961), the “previous year” can be defined as the year preceding the year of assessment. Therefore, the income earned in a year is taxable in the next year.

The tax liability of an individual taxpayer depends on the person’s residential status: a taxpayer can be either a resident or a non-resident. According to Singhania and Singhania (2012:27), the following types of residential status exist:

- resident and ordinarily resident in India;
- resident but not ordinarily resident in India; and
- non-resident in India.

4.3.1.1 Resident and ordinarily resident

To determine whether an individual is “resident and ordinarily resident”, it should first be determined whether an individual is a resident. Once this has been established, it can be decided whether the person is “ordinarily resident” (Singhania & Singhania, 2012:27). The relevant terms are clarified below.

The definition of a resident according to section 6(1) of the Indian Income Tax Act, 1961 (India, 1961) is as follows:

“An individual is said to be a resident in India in any previous year, if he/she:
• is in India in that year for a period or periods aggregating in all to one hundred and eighty-two days or more; or

• having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more and is in India for a period or periods amounting in all to sixty days or more in that year."

The above is referred to as the “basic conditions” of being a resident. The last basic condition has the following exceptions:

• an Indian citizen who leaves India in any previous year for (a) the purpose of employment outside India or (b) as a member of the crew of an Indian ship; or

• an Indian citizen or a person of Indian origin, who, being outside India, visits India during the previous year.

Therefore, when one of the above circumstances exists, residency is only determined by complying with the first basic condition in section 6(1) of the Indian Income Tax Act, 1961 (Singhania & Singhania, 2012:29).

In terms of section 6(6) of the Income Tax Act, 1961 (cited in Singhania & Singhanai, 2012:29) the following additional criteria need to be met before a person can be defined as ordinarily resident:

• the individual has been resident in India in at least two out of ten previous years immediately preceding the relevant previous year; and

• the individual has been in India for a period of 730 days or more during seven years immediately preceding the relevant previous year.

To summarize, an individual becomes resident and ordinarily resident in India if the person satisfies at least one of the basic conditions and the two additional requirements mentioned above (Singhania & Singhania, 2012:29).
Singhania and Singhania (2012:29) list a number of aspects that should be noted when determining whether the conditions for being classified as resident and ordinarily resident are met:

- the stay does not have to be at one place and equally does not have to be continuous;
- the purpose and place of stay are immaterial; and
- if a person is in India only for a part of a day, the calculation of physical presence in India is done on an hourly basis.

4.3.1.2 Resident but not ordinarily resident

According to sections 6(1) and 6(a) of the *Income Tax Act, 1961* (cited in Singhania & Singhania, 2012:29-30), an individual is not classified as ordinarily resident in India if he/she satisfies at least one of the basic criteria listed under resident definition in chapter 4.3.1.1 of the current study, but complies with only one or none of the additional requirements listed under ordinary resident definition. In this case, the person has a “resident but not ordinarily resident” status.

4.3.1.3 Non-resident

A person is classified as a “non-resident” if he/she fails to comply with any of the basic conditions listed in chapter 4.3.1.1 (Income Tax Department, n.d.).

4.3.2 India’s tax base system

Once the residential status of an individual has been determined as “resident and ordinarily resident”, “resident but not ordinarily resident” or “non-resident”, the income classification on which the individual is taxed can be determined.

If a taxpayer has a “resident and ordinarily resident” status, the person is taxed on his/her Indian income, as well as his/her foreign income, according to sections 5(1)(a)-(c) of the *Income Tax Act, 1961* (India, 1961). Consequently the person is
taxed on his/her worldwide income (similar to South Africa’s residence-minus system). Foreign income is income that is neither received in India, nor arises in India (Singhania & Singhania, 2012:38).

According to sections 5(1)(a)-(c) of the *Income Tax Act, 1961* (India, 1961), any of the following three income categories is classified as Indian income:

- income received (or deemed to have been received) and that arose (or is deemed to have arisen) in India;
- income received in India, but that arose outside India; and
- income received outside India but that arose in India.

According to section 5(1) of the *Income Tax Act, 1961* (India, 1961), if a taxpayer is classified as “resident but not ordinarily resident”, the person is taxed on his/her Indian source income and is only taxed on his/her foreign income in the following circumstances:

- if the business income and the business are wholly or partly controlled from India; and
- if it involves professional income from a profession which is set up in India.

Except for the two circumstances listed above, in any other case, foreign income is not taxable in the hands of a person who is resident, but not ordinarily resident, in terms of section 5(1) of the *Income Tax Act, 1961* (India, 1961).

A non-resident taxpayer is only taxed on income received or accrued in India. All foreign income is excluded in determining the non-resident’s Indian tax liability, in terms of sections 5(2)(a)-(b) of the *Income Tax Act, 1961* (India, 1961).

Indian nationals who live abroad are considered non-residents if they do not comply with the basic conditions of residency discussed under chapter 4.3.1.1. In that case, they are only taxed on income received or accrued in India, in terms of sections 5(2)(a)-(b) of the *Income Tax Act, 1961* (India, 1961). No mention is made of Indian emigrants.
The incidence of tax for different taxpayers is illustrated in Table 4, below.

### Table 4: Incidence of different taxpayers

<table>
<thead>
<tr>
<th>Types of Income</th>
<th>Income taxable</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Resident and Ordinarily Resident</td>
</tr>
<tr>
<td>Indian income</td>
<td>Yes</td>
</tr>
<tr>
<td>Foreign income</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Source: Singhania and Singhania (2012:38).

According to sections 14 and 56 of the *Income Tax Act, 1961* (India, 1961), the income of a taxpayer is computed under five sections:

- salaries;
- income from house property;
- profits and gains from a business or profession;
- capital gains; and
- other income (such as dividends, interest on securities and rental income of machinery and equipment).

Some examples of exempt income under section 10 of the *Income Tax Act, 1961* (India, 1961) are

- income from a provident fund;
- interest from exempted securities;
- leave payment to a government employee;
- local dividends;
- a retrenchment payment; and
- a scholarship received for the purpose of education.

Deductions (to name but a few) available to a taxpayer in terms of sections 24, 30 and 80 of the *Income Tax Act, 1961* (India, 1961) are
• annual house property deductions;
• donations for scientific research;
• medical aid contributions;
• political party contributions;
• rental expense, rates and taxes, maintenance, insurance and depreciation of a building (if a taxpayer has profit and gains from a business or profession); and
• rent paid for residential accommodation.

4.3.3 Summary

How to determine the tax base for an individual taxpayer in terms of Indian tax legislation is illustrated in Figure 2, overleaf.
Basic conditions:
1. Total of 182 days in India in the previous year; or
2. 60 days or more in India in the previous year and 365 days or more during 4 years immediately preceding previous year
(Bear in mind exceptions to 2nd basic condition)

Consider the following

Yes

1. Only liable for tax on Indian income
2. Foreign income not taxable in India

No

Consider the following

1. Indian resident for at least 2 out of 10 previous years immediately preceding the previous year; and
2. 730 days or more in India during 7 years immediately preceding the previous year

Resident and ordinarily resident liable for tax on:

Worldwide income:
1. Indian income
2. Foreign income

Resident but not ordinarily resident liable for tax on:

1. Indian income
2. Two types of foreign income:
   • Business income and business wholly or partly controlled from India, and
   • Income from profession which is set up in India
3. Any other foreign income is not taxable
4.4 THE UK

The key terms that are relevant to the UK tax base and the tax base that is applied in the UK tax system are discussed in this chapter. At the end of the chapter, a summary is provided on how to determine an individual’s tax base.

4.4.1 Key terms

It is important to understand the term “resident in the UK”, because this determines the extent of a person’s income tax liability. The terms “residence” and “ordinary residence” are not defined in the Tax Acts and guidance supplied is mainly based on the rulings of the courts. “Dual residence” occurs when a person is defined as a resident of the UK, as well as a resident of another country. In this case, the double tax agreement in place will determine which country has the primary right to tax the individual (HM Revenue & Customs, 2011:5-6).

The statutory resident test is a revision to the current law. It was effected on 6 April 2013. The reason for implementing this test was to provide more clarity when determining the residential status of a person (Ernst & Young, 2013:24). The statutory resident test is discussed separately from residence, non-resident, ordinary residence and domicile.

4.4.1.1 Residence

The factors which need to be considered to determine whether an individual is a resident of the UK are discussed below.
The only instance when the **number of days** is the deciding factor to determine whether an individual is a UK resident is when the person is present in the UK for 183 days or more in a particular tax year. If the person meets this criterion, the person is a resident of the UK, and there are no exceptions to this rule (HM Revenue & Customs, 2011:6). According to section 4(2) of the *Income Tax Act, 2007* (UK, 2007), a tax year can be defined as a year for which income tax is charged.

However, if a person is present in the UK for fewer than 183 days in a given tax year, that person can still be classified as a resident of the UK, depending on the frequency, duration, purpose and pattern of the stay, as well as the person’s connections to the UK. If the nature and degree of a person’s connections to the UK indicate that it is usual for that person to live in the UK, then he/she is classified as a resident of the UK. The reason as to why a person is living in the UK is irrelevant and the reasons can vary between employment, leisure or simply enjoyment of stay in the UK (HM Revenue & Customs, 2011:6-7).

**Court cases supporting** the definition of residence should be taken into account when considering whether an individual is a resident of the UK, which includes duration of stay in the UK and how regularly and frequently the visits occur (*Commissioners of Inland Revenue v Zorab* (1926) 11 TC 291).

*Levene v Inland Revenue Commissioners* (1928) 13 TC 505 carries authority for the argument that the words “residence” and “to reside” mean “to dwell permanently or for a considerable time, to have one’s settled or usual abode, to live in or at a particular place.”

However, as stated in *Lysaght v Commissioners of Inland Revenue* (1928) 13 TC 511, 529, short but regular periods of physical presence may in effect amount to residence, especially if they stem from the performance of any continuous obligation (such as a business obligation), and the sequence of visits excludes the elements of chance and of occasion.
In *Gaines-Cooper v Commissioners for HM Revenue & Customs* (2006) UKSPC SPC00568 it was stated “…that the fact that an individual has a home elsewhere is of no consequence; a person may reside in two places but if one of those places is the United Kingdom he is chargeable to tax here”. Furthermore, *Inland Revenue Commissioners v Duchess of Portland* (1982) STC 149 at 155c confirms that a person can be simultaneously resident in two countries. In that case, the deciding factor is which country the person inhabits.

### 4.4.1.2 Statutory residence test (SRT)

The purpose of the SRT is to determine whether an individual is a resident in the UK (HM Revenue & Customs, n.d.(d)). This test determines a person’s residence status only from 2013-2014 onwards (HM Revenue & Customs, 2013:78).

The broad structure of the residence rules has not changed. This includes the definitions of individuals who are undoubtedly residents and non-residents (Truman, 2013). However, an important change that should be noted is the elimination of the concept of “ordinary residence” as far as possible (HM Revenue & Customs & HM Treasury, 2012:3). The SRT includes three main tests, which are the “automatically resident” test, the “automatic overseas” test and, lastly, the “sufficient ties” test (Ashby, 2012b).

A person is automatically a UK resident if he/she meets one of the automatic UK residence tests. However, if the person also meets any of the automatic overseas tests, he/she is not regarded as a UK resident. Only once the automatic residence and automatic overseas tests have been considered is the sufficient ties test applied to determine whether a person is a UK resident (Ashby, 2012b). The tests are summarised below.

The four automatic UK tests include the following (HM Revenue & Customs, 2013:16,22,41):

- having spent more than 183 days in the UK in the current tax year (the 183-days rule);
• having had a home in the UK in the current tax year and having spent a sufficient amount of time there;
• working full time in the UK without significant breaks; and
• dying in the tax year and failing the “other residence tests” test.

For the purpose of the SRT, a “home” can generally be defined as “…a place that a reasonable onlooker with knowledge of the material facts would regard as that person’s home” (HM Revenue & Customs, 2013:81). Even though it is possible for a person to have more than one home, mostly a person has only one place where he/she lives, and this place is regarded as the person’s home. The facts and circumstances of its use by the individual are the deciding factors in determining whether a place is, or is not, a home (HM Revenue & Customs, 2013:81).

According to HM Revenue & Customs (2013:8), the automatic overseas tests include the following:
• spending less than 16 days in the UK in the current tax year and being a UK resident for one or more of three tax years preceding the current tax year;
• spending less than 46 days in the UK in the current tax year and being a non-resident for none of the three tax years preceding the current tax year; and
• working abroad full-time (with no significant breaks) and spending less than 91 days in the UK in the current tax year. However, the days worked in the UK for more than three hours at a time should be fewer than 31 days.

According to HM Revenue & Customs (2013:45-47), the sufficient ties tests include the following five ties:
• a family tie;
• an accommodation tie;
• a work tie;
• a 90-days tie; and
• a country tie (leavers only).

Under the accommodation tie, the term “available accommodation” is used. The accommodation should be available for a continuous period of 91 days (excluding any casual or social visits). A person is not required to own the accommodation, and the accommodation can be any type of accommodation, whether it is a holiday home, accommodation provided by an employer, etc. The main difference between a “home” and “available accommodation” is that available accommodation is temporary, whereas a home is permanent in nature. As in the case of determining a person’s home, the determination of available accommodation depends on “…the facts and circumstances of its use by the individual” (HM Revenue & Customs, 2013:86-87).

whether somewhere is or is not an accommodation tie will always be dependent on the facts and circumstances of its use by the individual.

Broadly, under the sufficient tie test, the ties together with the days spent in the UK are counted and the results are looked up on one of two tables. If a person is an “arriver”, then four ties are applicable, compared to five ties if a person is a “leaver” (Ashby, 2012b).

When a person determines his/her residence status for the tax year 2013-2014 under the automatic overseas tests or sufficient ties tests, the person is required to know his/her residence status for one or more of the three tax years prior to the 2013-2014 tax year. These years are referred to as “pre-commencement tax years” (HM Revenue & Customs, 2013:78).

The standard position to determine a person’s residence status for a pre-commencement tax year requires referring to the rules under the residence, domicile and remittance basis (HM Revenue & Customs, 2013:78). It is therefore important to discuss the terms and tax base of both the previous system (residence, domicile and remittance basis under HM Revenue & Customs, 2011) and the new rules under the SRT. However, a taxpayer can elect to use the SRT
to determine his/her residence status for the pre-commencement tax year (HM Revenue & Customs, 2013:78).

4.4.1.3 Non-resident

If a person does not comply with the UK residency criteria, he/she is regarded as a non-resident of the UK. However, if the taxpayer’s normal home is outside the UK and he/she is in the UK for less than 183 days in the tax year, he/she can still be a resident (HM Revenue & Customs, 2011:79). “Being a resident in the UK is not simply a question of the number of days you spend in the country.” (HM Revenue & Customs, 2011:79).

4.4.1.4 Ordinary residence

“Ordinary residence” differs from “residence”. The word “ordinary” indicates that a person's residence in the UK is customary and not accidental. If a person has always lived in the UK, the person is ordinarily resident in the UK. A person can be resident in the UK but not ordinarily resident there, which indicates that the UK resident normally lives somewhere else (HM Revenue & Customs, 2011:79).

The following elements should be considered to determine whether a person who has not always lived in the UK is an “ordinary resident” in the UK (HM Revenue & Customs, 2011:9,79):

- whether the person’s presence in the UK has a settled purpose;
- whether the person’s presence in the UK forms part of the regular and habitual mode of his/her life for the time being; and
- whether the person has entered the UK voluntarily.

Court cases supporting the definition of ordinary residence must be taken into account. “Ordinary resident” refers to a person’s abode in a particular place or country which he/she has adopted voluntarily and for settled purposes as part of the regular order of his/her life, whether of short or long duration (R v Barnet LBC ex p Shah (1983) 2 AC 309, 343).
Gaines-Cooper v Commissioners for HM Revenue & Customs (2006) UKSPC SPC00568 189 confirmed “that the concept of ‘ordinary residence’ requires more than mere residence, it connotes residence in a place with some degree of continuity and ‘ordinary’ means normal and part of everyday life.”

4.4.1.5 Domicile

Where a person is domiciled is a matter of general law and does not depend on tax law (HM Revenue & Customs, 2011:12). When determining in which country a person is domiciled, the following points should be taken into account (HM Revenue & Customs, 2011:12):

- a person cannot be without a domicile;
- a person can only have one domicile at a time;
- the country where a person has his/her permanent home is usually an indication of his/her domicile;
- existing domicile continues until a new domicile is acquired;
- domicile is detached from nationality and residence, although both can have an influence on a person’s domicile; and
- registration and voting in an overseas election is irrelevant and should not be taken into account.

Court cases supporting the definition of domicile have to be consulted. Inland Revenue Commissioners v Bullock (1976) STC 409 at 414d states that “A man may have homes in more than one country at one time. In such a case, for the purposes of determining his domicile, a further enquiry may have to be made to decide which, if any, should be regarded as his principal home.”

Udny v Udny (1869) L R 1 SC & Div 441 confirms that the domicile of choice relates to a person’s fixing his/her chief residence voluntarily in a particular place with the intention of residing there for an unlimited time.
Buckley LJ in *Inland Revenue Commissioners v Bullock* (1976) STC 415 a-b said “…the question was whether the person whose domicile was in question had ‘determined’ to make, and had in fact made, the alleged domicile of choice ‘his home with the intention of establishing himself and his family there and ending his days in that country’ “.

In the case of *Plummer v IRC* (1998)(BTC 543), the taxpayer’s family moved to Guernsey, but the taxpayer remained in the UK to complete her education. It was found that she had not acquired a domicile of choice in Guernsey, since she had not lived there on a permanent basis.

In *Civil Engineer v IRC* (2002) (STC (SCD) 72) (cited in Zelinsky, 2011:1336-1337), a taxpayer lived in Hong Kong for 29 years, whereafter he returned to the UK. During his time in Hong Kong, he set up two trusts, and he argued that he had obtained a domicile of choice there. The taxpayer’s argument was dismissed, because it was found that he had no substantial evidence that his intention was to return to Hong Kong, and this revived his UK domicile of origin.

*Gaines-Cooper v Commissioners for HM Revenue & Customs* (2006) UKSPC SPC00568 189 concluded that a domicile of choice is acquired by a combination of residence and the intention of a permanent residence. The evidence should be reviewed in total, including scrutinizing the events which occurred after the claimed acquisition of a domicile of choice.

### 4.4.2 The UK’s tax base system

The tax base system under the previous HM Revenue & Customs guidelines, as well as under the newly implemented statutory resident test, is discussed below. The tax base is influenced by whether a person is

- resident;
- resident, ordinarily resident but not domiciled;
- resident, not ordinarily resident but domiciled;
• resident, not ordinarily resident and not domiciled; or
• non-resident.

4.4.2.1 Resident in terms of HM Revenue & Customs’s (2011) guidelines

Residents in the UK are taxed on an "arising basis of taxation". This means that a resident pays tax on income which arises in and outside the UK, and pays tax on gains on the disposal of worldwide assets (HM Revenue & Customs, 2011:6). Residents are therefore taxed on their worldwide income.

When the resident is liable for UK tax on the “arising basis”, the following income categories are taxed (HM Revenue & Customs, 2011: 55-56,65):

• income from employment, regardless of where the duties of employment are carried out;
• income from any trade, profession or vocation, whether it was carried out in or outside the UK;
• local and foreign pensions (with a possible 10% deduction on foreign pensions);
• lump sums from foreign pension schemes or provident funds; and
• investment income (interest, dividends and rental income).

The following items (among others) are exempt from UK income tax, according to sections 691, 709, 718, 752 and 776 of the ITTOIA 2005 (UK, 2005) and HM Revenue & Customs (n.d.(a)):

• annuities;
• employment and support allowance;
• a housing allowance (state benefit);
• interest on deposits with the National Savings Bank (if interest does not exceed £70);
• interest under employees’ share schemes;
• a maternity allowance (state benefit);
• scholarship income; and
• venture capital trust dividends (conditions apply).

Tax allowances and reliefs available to a UK taxpayer are the following (HM Revenue & Customs, n.d.(a)):
• business expenses incurred during execution of job;
• donations giving to charity;
• maintenance payments to an ex-spouse or former civil marriage partner (only if the person making the payment is liable for UK tax, as this allowance reduces the tax liability of that person making the payment);
• a married couple’s allowance (only if the person receiving the allowance is liable for UK tax, as this allowance reduces the tax liability of the recipient);
• pension contributions (only if person that contributes to the pension fund is liable for UK tax, as this allowance reduces the tax liability of the person contributing);
• a personal allowance (this depends on date of birth and taxable income – as it reduces taxable income);
• professional fees and subscriptions; and
• tax allowances and reliefs when self-employed (in production of income).

There are similarities between the tax base of a UK resident and that of the South African residence minus system. A UK resident is equally liable for income tax on his/her worldwide income (income arising in and outside the UK) after certain tax allowances and reliefs have been taken into account.

4.4.2.2 Ordinary resident and domiciled in terms of HM Revenue & Customs’s (2011) guidelines

Only if a resident earns foreign income is it relevant to determine whether the resident is “ordinarily resident” and “domicile” (HM Revenue & Customs, 2011:9).
When a taxpayer is a resident and ordinarily resident, but not domiciled, he/she is liable for tax on the following income categories:

- any UK employment income and overseas employment income where any duties of employment are carried out within the UK (arising basis);
- foreign employment income where work is performed solely outside the UK for a foreign employer but paid in the UK;
- earnings from any trade and profession, irrespective of whether the trade is carried out in the UK or abroad (arising basis); and
- pensions from the UK and abroad (arising basis) (HM Revenue & Customs, 2011:55-56).

However, if any of the overseas employment duties are performed wholly or partly outside the UK for a UK employer (therefore not a foreign employer), the taxpayer is not able to claim the remittance basis and the taxpayer is liable for tax on his/her income earned both in the UK and abroad (arising basis) (HM Revenue & Customs, 2011:56).

If a resident is not ordinarily resident and not domiciled, he/she is liable for tax on the UK source income but is only liable for tax on the amount of foreign income and gains that are remitted to the UK (“remittance basis”) (HM Revenue & Customs, 2011:6, 9, 12).

If a resident taxpayer claims the remittance basis (therefore claims that he/she is not ordinarily resident and not domiciled in the UK), the person is liable for UK tax on the following income items (HM Revenue & Customs, 2011:55-56, 66):

- UK employment earnings;
- earnings from employment abroad if the earnings are paid in the UK;
- earnings from any trade or profession carried out in the UK;
- earnings from any trade or profession carried out exclusively outside the UK, if the earnings are paid in the UK;
- UK pensions;
• foreign pensions if they are paid in the UK (a 10% deduction is then not allowed);
• UK source investment income; and
• foreign investment income, if it is paid in the UK.

In a case where a resident is not ordinarily resident, but is domiciled in the UK, the person cannot claim the remittance basis, and the taxpayer is liable for tax on his/her worldwide income (arising in and outside the UK) (HM Revenue & Customs, 2011:6,9,12).

4.4.2.3 Non-resident in terms of HM Revenue & Customs's (2011) guidelines

Where a non-resident essentially carries out his/her duties determines whether his/her income is from a UK source or a foreign source. This is important, as non-residents are only taxed on UK source income (HM Revenue & Customs, 2011:57).

Examples of non-resident income liable for UK tax are the following (HM Revenue & Customs, 2011: 57-58,66):

• earnings from employment carried out in the UK (unless UK duties are incidental);
• income and profits from a trade or profession carried out exclusively in the UK;
• pensions from sources in the UK; and
• investment income from UK sources (interest, dividends and rental income).

The tax liabilities of emigrants and persons leaving the UK to work abroad should also be considered. If a person emigrates from the UK, it means that the person has set up home elsewhere and all ties to the UK have been cut. In this case, the person will either leave the UK permanently, or indefinitely. “Permanently” refers
to leaving the country to live abroad, and “indefinitely” refers to living abroad for at least three years, although the person might eventually return to the UK.

If a person leaves the UK permanently or indefinitely, he/she becomes a non-resident (as well as not ordinary resident) from the day after his/her departure if the person is outside the UK for a full tax year (6 April of the one calendar year to 5 April of the next calendar year). If the person complies with these rules, he/she is only taxed on his/her UK source income, if he/she has any (HM Revenue & Customs, 2011:43-45). While a person is outside the UK, he/she must ensure that the 183 day rule is not breached. To retain non-resident status, visits to the UK may not exceed 183 days in any tax year and may not exceed 91 days a year on average over the period of non-residency (UK Expat, 2009). If these rules are breached, a person is considered a resident of the UK and is consequently liable for tax on his/her worldwide income (UK Expat, 2009).

If a person leaves the UK to work abroad full-time, he/she becomes a non-resident and is not regarded as an ordinary resident as long as he/she

- is working abroad under an employment contract for at least a full tax year;
- has physically left the UK to start employment;
- is absent from the UK for at least a full tax year; and
- visits to the UK for less than 183 days in any tax year and on average less than 91 days a tax year (HM Revenue & Customs, 2011:47).

A person working abroad is only liable for tax on income earned in the UK as he/she is considered a non-resident of the UK (HM Revenue & Customs, 2011:57).

4.4.2.4 Statutory resident test (new rules)

The SRT is only applied to determine whether a person is a resident. As the broad structure of the residence rules has not changed (Truman, 2013), it is assumed that if a person is defined as a resident of the UK under the SRT,
he/she is taxed on the arising basis. It is also assumed that a non-resident is taxed on a UK source income, as previously discussed in chapter 4.4.2.3 above.

Because in the SRT the term “ordinary residence” is disregarded (HM Revenue & Customs & HM Treasury, 2012:3) and no reference is made to “domicile”, it is also assumed that the tax treatment under ordinary residence and domicile discussed previously should be disregarded.

4.4.3 Summary

How to determine the tax base for an individual taxpayer in terms of the UK’s tax legislation is illustrated in Figure 3, overleaf.
Figure 3: UK tax base summary

1. **Days of presence in the UK:**
   - 183 days or more vs. less than 183 days

Consider the following:

**1. Days of presence in the UK:**
- 183 days or more vs. less than 183 days

**2. Income arising in and outside UK and gains on disposal of worldwide assets**

**3. Taxed on **arise basis**

**4. Taxed on **income earned in the UK**

**5. Remittance basis = Taxed on foreign income if paid in the UK**

**Ordinarily Resident**

1. **Always lived in the UK**
2. **Presence has settled purpose**
3. **Regular and habitual mode**

**Domicile**

1. **Cannot be without domicile**
2. **Only have one domicile at a time**
3. **Usually country of permanent home**

**Ordinary Resident**

1. **Taxed on UK source income**
2. **Can claim remittance basis for foreign income**
3. **Remittance basis = Taxed on foreign income if paid in the UK**

1. **Only taxed on income earned in the UK**
2. **Any income from employment duties and from business carried out solely abroad = not taxable**

© University of Pretoria
4.5 THE US

The key terms relating to the tax base as well as tax base applied in the United States tax system are discussed in this chapter. At the end of the chapter, a summary is provided on how to determine an individual’s tax base.

4.5.1 Key terms

The meanings of key concepts are considered below.

4.5.1.1 Alien

An alien is defined as an individual who is not a US citizen or a US national (IRS, 2013b).

4.5.1.2 US national

A US national is a person who owes his/her sole adherence to the US (IRS, 2013b).

4.5.1.3 Immigrant

An immigrant is an alien who has been granted the right by the US Citizenship and Immigration Services to reside permanently in the US and to work in the US without any restrictions. Immigrants are also referred to as Lawful Permanent Residents (IRS, 2013b).

4.5.1.4 US citizen

The key elements (among others) of the definition of a US citizen as set out in section 1401 of the United States Code (US Code, 2012) are the following:

- “a person born in the United States, and subject to the jurisdiction thereof;
- a person born in the United States to a member of an Indian, Eskimo, Aleutian, or other aboriginal tribe;
• a person born outside of the United States and its outlying possessions of parents both of whom are citizens of the United States and one of whom has had a residence in the United States or one of its outlying possessions, prior to the birth of such person;

• a person born outside of the United States and its outlying possessions of parents one of whom is a citizen of the United States who has been physically present in the United States or one of its outlying possessions for a continuous period of one year prior to the birth of such person, and the other of whom is a national, but not a citizen of the United States; and

• a person born in an outlying possession of the United States of parents one of whom is a citizen of the United States who has been physically present in the United States or one of its outlying possessions for a continuous period of one year at any time prior to the birth of such person."

4.5.1.5 Resident aliens

Two tests can be applied to determine whether an individual is a resident alien:

• the Green Card test; or

• the substantial presence test (IRS, 2011:4).

According to section 1101 of the US Code (US Code, 2012), an alien can be defined as any person who is not a citizen or national of the US.

4.5.1.6 Green Card test

In terms of section 7701(b) of the Internal Revenue Code (IRS, n.d.), an alien in possession of a Green Card is considered a resident of the US. Once the person has achieved this “lawful permanent resident” status, the person will retain that status unless it is either revoked or administratively or judicially abandoned, or when the Green Card holder is classified as a resident of a foreign country under the provisions of a tax treaty between the US and that foreign country (Westin, 2011:125).
4.5.1.7 Substantial presence test

This test has two aspects. An alien is required to be present in the US for at least 31 days in a particular calendar year, and in addition, he/she is also required to meet the 183-day test (IRS, 2011:4).

The 183-day test is met if the sum of the days present in the US during the tax year, plus one third of the days present during the immediate preceding calendar year, plus one sixth of the days present during the second preceding year is equal to or exceeds 183 days (IRS, 2011:4).

Westin (2011:126) states that an alien individual who meets both the 31-day test and the 183-day test is still not a resident if the following conditions apply:

- the person is present for fewer than 183 days in the US in the current year;
- the person has a tax home in a foreign country during the current year; and
- the person has a closer connection to the foreign country than to the US.

A person’s tax home can thus be defined as the place where a person permanently works as an employee or self-employed person, regardless of where the person maintains his/her family home (IRS, 2012a:12).

4.5.1.8 Non-resident alien

A person is considered a non-resident alien if he/she is neither a US citizen nor a resident alien (IRS, 2012b).

Court cases interpreting the term residence must be considered. In the case of Commissioner v. Swent [46-1 USTC ¶9266], 155 F. 2d 513, 272 F. 2d 709, c.d. 329 U.S. 801, “residence” and “domicile” were distinguished from one another. The difference between “residence” and “domicile” was also confirmed in Fuller v. Hofferbert [53-1 USTC ¶9405], 204 F. 2d 592 (6CCA). The court stated that “domicile” and “residence” are frequently used as if they had the same meaning. However, the court considered this to be incorrect, as “domicile” refers to living in
a locality with the intent to make it a permanent home, whereas “residence” simply requires physical presence as an occupant in a given place.

A non-resident alien cannot establish a residence in the US by intent alone. The intent should be accompanied by an evident act, for example making one’s home in the US for a certain time (de la Begassiere v. Commissioner [CCH Dec. 23,466], 31 T. C. 1031).

4.5.2 The US’s tax base system

The US has a unique tax base system for taxing individuals, and therefore it is critical to determine whether a person is a citizen, a resident alien or a non-resident alien.

If a person is a US citizen or a resident alien, regardless of where he/she is living, his/her worldwide income is generally subject to US income tax in terms of section 1 of the IRC (IRS, n.d.). A non-resident alien is only taxed on his/her US source income, but in limited circumstances certain foreign income is also subject to US income tax (IRS, 2011:11,18).

4.5.2.1 US citizen or resident alien

In the case where a person is a US citizen or resident alien (also referred to as a lawful permanent resident), the tax base is calculated by three elements: gross income, exemptions excluded from gross income and deductions subtracted from gross income, resulting in the individual’s taxable income. This tax system is similar to the “residence-minus” system applied in South Africa. A few examples of each element are listed below.


- compensation for services (salaries, fees, commissions etc.);
- business income;
- profits resulting from dealings in property;
- interest;
- rental income;
- dividends;
- pensions; and
- annuities.

**Exemptions from gross income** include (sections 102, 103, 115, 117, 121 and 139 of the Internal Revenue Code (IRS, n.d.); IRS, 2011:16):

- disaster relief receipts;
- foreign earned income exclusions;
- gifts and inheritances;
- interest on State and local bonds;
- income of states, municipalities, etc.;
- qualified scholarships; and
- profit from the sale of a person’s principal residence.

**Deductions from gross income** include (sections 63, 151, 165, 212, 213, 215, 217, 221 and 222 of the Internal Revenue Code (IRS, n.d.)):

- alimony payments;
- expenses for production of income;
- higher education expenses;
- interest payments on loans for higher education;
- loss from sale of property;
- medical and dental expenses;
- moving expenses;
- personal exemptions; and
- standard deductions.
As this tax base is based on the worldwide income regime, US citizens and resident aliens are taxed on their foreign income earned, unless they opt for the foreign earned income exclusion (IRS, 2011:16). Foreign earned income can be defined as income received from performing personal services in a foreign country. Where or how a person is paid has no effect on the source of the income (IRS, 2013a).

If an individual has paid or accrued foreign taxes to a foreign country on foreign source income and is subject to US tax on the same income, the person is either entitled to a credit or a deduction for those taxes. A deduction results in a reduction in US taxable income, whereas a credit results in a reduction of US tax liability. In most cases, the foreign tax credit is more favourable (IRS, 2013c:2).

If a person is permanently engaged to work as an employee in a foreign country and complies with the residence or physical presence test, he/she can elect to exclude from his/her income a limited amount of his/her foreign earned income. If the person decides to select this exclusion, he/she cannot deduct, exclude or claim a credit for any item that can be allocated to the excluded amounts (IRS, 2012a:19).

According to section 1 of the Internal Revenue Code (IRS, n.d.), US citizens and resident aliens living and working abroad are still liable for tax on their worldwide income earned unless they surrender their citizenship or Green Card.

What would the tax implication be if a US citizen or resident alien surrenders his/her citizenship or legal permanent residency (or Green Card) to avoid tax? Sections 887 and 887A of the US Code (US Code, 2102) deal with this situation by imposing expatriation tax. If an individual is classified as a “covered expatriate”, all his/her property is treated to be disposed of at fair market value on the expatriation date (the day the US citizen relinquishes his/her citizenship or the resident alien ceases to be a lawful permanent resident) (section 887A(1) and (3)(A)(B) of the US Code (US Code, 2012.)).
A “covered expatriate” is an individual whose average annual tax liability is greater than $124 000 for the five taxable years ending before the expatriation date, or his/her net worth at the date of expatriation is $2 000 000 or more (section 877(2) of the US Code (US Code, 2012).

4.5.2.2 Non-resident alien

A non-resident alien is usually subject to US income tax only on his/her US source income. In limited circumstances, certain foreign income is also subject to US income tax (IRS, 2011:11-14). Typical income categories are interest, dividends, personal services, pensions, annuities, rental income, royalties, profits from the sale of real and personal property (IRS, 2011:11-14).

The factors determining the source of income are summarised in Table 5, below.

Table 5: Summary of source rules for income of non-resident aliens

<table>
<thead>
<tr>
<th>Item of income</th>
<th>Factor determining source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, wages, other compensation</td>
<td>Where services are performed</td>
</tr>
<tr>
<td>Business income (personal services)</td>
<td>Where services are performed</td>
</tr>
<tr>
<td>Interest</td>
<td>Residence of payer</td>
</tr>
<tr>
<td>Dividends</td>
<td>Paid by a US corporation</td>
</tr>
<tr>
<td>Rental income</td>
<td>Location of the property</td>
</tr>
<tr>
<td>Royalties:</td>
<td></td>
</tr>
<tr>
<td>Natural resources</td>
<td>Location of the property</td>
</tr>
<tr>
<td>Patents, copyrights etc.</td>
<td>Where the property is used</td>
</tr>
<tr>
<td>Sale of real property</td>
<td>Location of the property</td>
</tr>
<tr>
<td>Sale of personal property</td>
<td>Location of seller’s tax home (where you permanently work as an employee)</td>
</tr>
<tr>
<td>Pension distributions attributable to contributions</td>
<td>Where services were performed that earned the pension</td>
</tr>
</tbody>
</table>

*Source:* Adapted from IRS (2011:14).

As mentioned earlier (see chapter 4.5.2), in limited circumstances, certain foreign income is subject to US income tax. If a non-resident alien has an office in the US, the office is a material factor in the production of income and the income is
produced in the ordinary course of business through the office, then three kinds of foreign source income are connected with a business in the US and are therefore subject to US income tax. The three types of foreign source income are rents and royalties, dividends and interest, and profits or losses from a sale outside the US through the US office (IRS, 2011:20).

4.5.3 Summary

How to determine the tax base for an individual taxpayer in terms of the US’s tax legislation is illustrated in Figure 4, overleaf.
Figure 4: US tax base summary

US citizen

No

Resident alien

No

Non-resident alien

Consider the following

Various key elements discussed under US citizen definition

Yes

Yes

Consider the following

1. Green card test
2. Substantial presence test
   - 31 days presence test and
   - 183 days presence test

Yes

1. Taxed on US source income
2. Income connected to business in the US
3. Income not connected to business in the US
4. Limited circumstances foreign income earned also taxable

1. Taxed on worldwide income
2. Source of income is irrelevant
3. Foreign income earned can be excluded in certain circumstances
CHAPTER 5: RESEARCH DESIGN AND METHODS

5.1 DESCRIPTION OF INQUIRY STRATEGY AND BROAD RESEARCH DESIGN

As indicated in chapter 1.2 of this study, no research involving a comparison of South Africa’s residence-based tax system to that of other developing and developed countries could be identified. To perform this comparison, the research was of a qualitative nature, and it was concluded that a non-empirical research method would be most appropriate for this study.

Non-empirical research methods consist of conceptual analysis, theory-building studies, philosophical analysis and literature reviews (Mouton, 2001:175-179). This study focuses only on literature reviews. A literature review is a critical and reasonable analysis and interpretation of the advantages and restrictions of the literature within a selected area (Saunders, Lewis & Thornhill, 2012:668).

The purpose of critically reviewing the literature is to establish the groundwork on which the research is built, to develop a good understanding and insight into relevant previous research conducted, as well as to review the most relevant and significant research on the specific topic selected. A literature review also identifies research possibilities that have been overlooked, and therefore recommendations for further research are recognised (Saunders et al. 2012:73-74).

According to Saunders et al. (2012:72), the components of a literature review include the following:

- conducting the research;
- obtaining literature;
- reading and evaluating the literature; and
recording the concepts and starting to draft the review.

In evaluating the literature that has been identified as relevant, a content analysis was performed. A content analysis is a detailed and methodical examination of the content of a particular form of material for the purpose of identifying outlines, themes, or preferences (Leedy & Ormrod, 2012:148). In principle, a content analysis is systematic and includes the following four steps (Leedy & Ormrod, 2012:149):

- Step 1: The form of material to be studied is identified;
- Step 2: Characteristics or qualities to examine are defined;
- Step 3: If the material to study is complex or lengthy, each item is broken down into smaller sections to study separately; and
- Step 4: The material is examined to identify characteristics and qualities as set out in the second step above.

In this study, literature that referred to the tax base of individuals was evaluated. The material consisted of pieces of legislation, publications by international organisations and government departments, books, newspaper articles, journal articles, electronic sources and court cases. This enabled an understanding of the issues and current debates of the subject matter, in this case, the tax regimes in place, as recommended by Mouton (2001:179-180).

The search engines used in the study were government websites (the Department of National Treasury and SARS for South Africa, HM Revenue & Customs for the UK, the Income Tax Department for India, and the IRS for the US), Google Scholar and the journal platforms Ebscohost and Proquest. In addition, where a reference was found to a relevant article in a particular journal article, that article was also reviewed. Additional journal articles were also obtained by referring to citations of articles obtained from electronic sources using the following key words:

- domicile;
- individual taxation;
• individuals;
• opinions of Indian, South African, UK, US tax systems;
• opinions of resident-based taxation;
• ordinarily resident;
• residence base;
• residence-based tax system;
• residency and worldwide taxation;
• resident;
• source base;
• SWOT analysis;
• tax base;
• tax base comparison;
• tax base of BRICS countries;
• tax expenditures;
• tax policies;
• tax policy in developing countries;
• tax reforms;
• tax regimes;
• taxation; and
• worldwide taxation.

In order to ensure that the most relevant data were obtained, the emphasis was on data from 2009 onwards.

Once all relevant material was acquired, a content analysis was performed to gain an understanding of the individual tax systems of South Africa, India, the UK and the US. Any similarities and differences between these tax regimes, as well as advantages and disadvantages were highlighted in order to suggest possible improvements and changes to South African tax legislation.
The advantages and disadvantages identified during the content analysis were evaluated against the ten guidelines of good tax policy according to AICPA. In this regard, AICPA recommends that these ten principles be taken into account when analysing proposals to change a tax rule or a tax system (AICPA, 2001:8). The ten guidelines are listed below:

- **Equity and fairness**: Similarly situated taxpayers should be taxed similarly;
- **Certainty**: The tax system should be unambiguous and clearly indicate when tax should be paid, what amount is to be paid and in what manner payment is required;
- **Convenience of payment**: The time of payment and method of payment should be convenient for the taxpayer;
- **Economy in collection**: Collection of taxes should be kept to a minimum for both the governments and taxpayers;
- **Simplicity**: Tax rules should be simple in order for taxpayers to understand them;
- **Neutrality**: The influence the tax legislation has on a taxpayer’s decisions as to how to carry out a transaction should be limited;
- **Economic growth and efficiency**: The tax system should not restrain economic growth;
- **Transparency and visibility**: Taxpayers should be aware of the different type of taxes that exist and when it is imposed;
- **Minimum tax gap**: Non-compliance should be minimised; and
- **Appropriate government revenues**: The tax system should indicate how much tax revenue would be collected and when it will be collected.

The perspectives of the OECD on the individual tax system are reviewed. The OECD is of the opinion that even though various personal income tax reforms occurred over the years, there is not yet any clear agreement on what constitutes the ideal personal income tax system (OECD, 2006:1). The OECD only refers to the rates at which an individual should ideally be taxed (OECD, 2006:3-4,7). Tax
rates do not form part of the tax base definition of this study, therefore the viewpoints of the OECD are not considered further.

An analysis of the tax base applied in each country, a comparison between the countries (identifying any similarities and differences), advantages, disadvantages and recommendations are discussed in Chapter 6.
CHAPTER 6: RESULTS

6.1 INTRODUCTION

The tax base of each of the four countries is analysed in the first part of this chapter. This analysis highlights relevant issues, and reviews the current debates of the tax base. The remainder of the chapter compares the countries (identifying similarities and differences), highlights the advantages and disadvantages of these countries’ tax base, and presents the recommendations in relation to the findings.

6.2 ANALYSIS OF THE FOUR COUNTRIES’ TAX BASES

As discussed in the introduction of the study (Chapter 1), the personal income tax reforms in South Africa over the last few years have not been adequate to increase tax revenue (Steenekamp, 2012:53). An extensive search of academic journals, books and the web provided little evidence of any examination of the current tax base used in South Africa. The only comments that could be identified regarding the current tax system focus on reasons for why SARS changed from a source-base to a residence-base system in 2001. The main reasons for the transition were to broaden the tax base and to align South Africa with international standards (Nyamongo & Schoeman, 2007:481). Even though SARS (2000b:4) has indicated that it is essential to refine the tax base continuously, whenever deficiencies in the system are revealed, since 2001, few refinements have been added.

As previously mentioned, Minister of Finance, Pravin Gordhan has “…initiated a far-reaching and fundamental review of South Africa’s tax system that will be undertaken by a team of eminent tax experts…” (Ensor, 2013a). The tax review committee will be appointed to evaluate South Africa’s tax system, compared to
international standards and practices, as well as the latest international initiatives to advance tax compliance and to deal with tax base erosion (Ensor, 2013a). The current study may provide insights that will assist the work of this committee.

An analysis of the tax bases applied in India, the UK and the US is undertaken in the remainder of this chapter. Similarities and differences are identified, and recommendations relevant to the South African tax system are presented.

6.2.1 India

The wave of tax reforms in developing countries has largely been driven by fiscal imbalances. Following economic crisis in India, a tax reform was initiated in 1991. The aims of this tax reform were to neutralise revenue shortfalls in the short term and to enhance revenue productivity in the long term (Rao & Rao, 2006:3,14-15). Revenue productivity can be described as the connection between tax revenue and a country’s GDP. It measures whether the revenue system is receptive to economic development or not (NEPAD-OECD, 2011:13).

The most salient proposals by the Indian tax reform committee were, first, lower marginal tax rates and, second, measures to broaden the tax base. These measures included minimising exemptions, as well as simplifying the laws and procedures (Rao & Rao, 2006:3,14-15).

Comments on and reviews of the Indian tax system mostly refer to marginal tax rates and the effect thereof on tax revenue. However, because marginal tax rates do not form part of the tax base definition of the study, further discussion of this topic is deemed to fall beyond the scope of the study.

The following challenges have been identified in the Indian tax system by Rao and Rao (2006:18,53-54,56)

- various incentives and concessions significantly erode the tax base;
- the Indian tax system is not simplified and transparent; and
due to democratic polity (in which several special interest groups influence policies), it is difficult to make the Indian tax system more rule-based.

Rao and Rao (2006:56) make the following recommendations aimed at strengthening the Indian tax system:

- the tax base should be broadened by withdrawing tax exemptions and concessions on income from specified activities;
- compliance cost should be minimised; and
- tax structures should be kept simple by reducing the number of tax brackets to two.

There has been significant progress in tax reforms in India in recent years, but, this is only the beginning – reforming a tax system is a continuous exercise to improve tax revenue, minimise distortions and improve equity (Rao & Rao, 2006:63).

6.2.2 The UK

It has been asked how a person can become “not resident” in the UK. Truman (cited in Cave, 2008) suggests that the answer to this is “I have no idea”. Truman (2013) argues that disputes about residence continue, and that the guidance in the IR20 booklet (HM Revenue and Customs, 2009), which was replaced by HRMC6 (HM Revenue & Customs, 2011), could not be litigated, except through judicial review.

Another issue that arises in respect of the UK’s tax base is how hard it is for a person to lose a UK domicile of origin. Civil Engineer v IRC (2002) (STC (SCD) 72) (mentioned in chapter 4.4.1.5 of the current study) is a perfect example of how a person’s UK domicile can continue to be linked to a person who leaves the UK (Harper, 2004).

The inability to determine how a person can establish or retain non-resident status was the reason for the UK’s decision to introduce a new test of personal
tax residence. This test is known as the statutory residence test (SRT) and is effective from 1 April 2013 (Ernst & Young, 2013:24). Guake (cited in McKie, 2013) rightly argues that the rules for determining a person’s UK residency should be clear, unambiguous and simple.

The incoming SRT will be an improvement on the current law, as it is another step towards a clear and simpler test of residence (Ashby, 2012b). However, Ashby (2012a) claims that the SRT has various shortcomings. This includes the fact that the term “home” is poorly defined, as the term means different things to different people. The concept of “available accommodation” has also come under fire, because this concept appears to be unclear and puzzling to taxpayers and practitioners alike. Thus, this legislation is moving towards the right direction, but the job is not yet done (Tax Advisor, 2012).

6.2.3 The US

The analysis of the US tax base is broken into three parts: an analysis of tax expenditure, a review of citizen-based taxation, and, an overview of the taxation of non-residents and lawful permanent residents.

6.2.3.1 Tax expenditure

Ideally, a tax policy should be structured in such a manner that it meets basic principles – a tax system should be simple, comprehensible and fair (Hungerford, 2006:12). Most importantly, a tax system should raise enough tax revenue to meet a government’s needs (Hungerford, 2006:12).

There is increasing interest in reforming individual income tax. The aim of such a reform would be to broaden the tax base and use the additional tax revenues generated to reduce tax rates, as well as to reduce the budget deficit. Another objective would be to keep or make the tax system progressive (Gravelle & Hungerford, 2012:1).
One way to broaden a tax base is to eliminate or reduce tax expenditure, because some analysts argue that tax expenditure increases the complexity and reduces the fairness and efficiency of a tax system (Hungerford, 2006:13). This aim is not easy to achieve, because a number of complex issues surround tax expenditure. Some of the issues include the effects of tax expenditure on taxpayers’ economic behaviour, and the fact that changes to tax expenditure could increase the administrative burdens on taxpayers and the IRS (Gravelle & Hungerford, 2012:1).

The potential to lower tax rates and increase revenues would be considerable if it is possible to overcome the obstacles of broadening the tax base by eliminating or reducing tax expenditure. Admittedly, as the experience of the previous four decades suggests, it is difficult to achieve significant individual income tax reforms (Gravelle & Hungerford, 2012:2).

### 6.2.3.2 Citizen-based taxation

Most academics agree that US citizen-based taxation is an anomaly, and argue that US citizens living abroad should not be taxed (Zelinsky, 2011:1291), but Zelinsky (2011:1291) disagrees with this argument. He believes that worldwide taxation of citizens is no different from international residence-based rules, and claims that an individual’s citizenship is simply a broad substitute for his/her domicile: citizenship and domicile, rather than his/her immediate physical presence, determine a person’s permanent commitment.

An analysis of international cases in other countries such as the UK supports the claim that the US system of citizen-based taxation typically achieves the same results as a residence-based tax system (Zelinsky, 2011:1291). The resemblance between citizen-based and residence-based taxation is highlighted by the UK case of *Civil Engineer v IRC* (2002) (STC (SCD) 72) (see UK court cases supporting the definition of domicile, in chapter 4.4.1.5), in that residence is explicitly defined as a domicile, the taxpayer’s permanent home.
Determining a taxpayer’s permanent home can be challenging. The benefit of a citizen-based system is that it achieves results more efficiently, because it avoids complex analyses around domicile. US citizenship is easy to establish, in contrast to domicile, which is fact-intensive. Taxpayers can manipulate their domicile, making it harder for a tax authority to ascertain and prove domicile (Zelinsky, 2011:1341,1346). The advantage of the US tax system is that citizenship is easy to establish, resulting in lower administration costs and eliminating the need for court cases to determine a term.

The debate on whether residents should rather be taxed on income arising within their respective territories (a source-based system) or taxed on their worldwide income (Zelinsky, 2011:1344) continues. How does this affect citizen-based taxation? Zelinsky (2011:1344) argues that if the principle of worldwide taxation is abandoned, so must citizen-based taxation, especially if citizen-based taxation is used as a substitute for the concept of domiciliary residence.

6.2.3.3 Non-residents and lawful permanent residents

The US is the only developed country that taxes non-resident citizens and lawful permanent residents on their worldwide income. The extent to which they should be taxed has been a subject for debate for many years (Schneider, 2012:3,5).

Currently US citizens and lawful permanent residents are taxed on their worldwide income, irrespective of their place of residence or their source of income. The value of citizenship that supposedly accrues to US citizens abroad is a key argument used to justify the worldwide taxation of non-residents. One of the benefits of citizenship most commonly mentioned is the protection afforded to US citizens abroad. However, this argument does not hold water today, because most expatriates live in stable countries (Schneider, 2012:17,18,46-48).

The right to vote is another frequently used justification for taxing expatriate citizens. This argument is not historically valid, because worldwide taxation preceded universal voting rights as well as lawful permanent residents do not have the right to vote. Another argument against worldwide taxation of US
expatriates is the problems the IRS experiences in enforcing compliance. Detecting overseas income is very difficult (Schneider, 2012:49,54-55). Indeed, it seems that the only real benefit of being a long-term citizen expatriate is the right to move or visit to the US without any restrictions (Schneider, 2012:50).

The only way to escape the burden of US taxation is for a person either to renounce citizenship or abandon his/her lawful permanent resident status. However, it seems unfair to force US citizens abroad to have to abandon their citizenship only in order to avoid a tax system that should not relate to them (Schneider, 2012:66). If a person decides to renounce his/her citizenship, or abandon his/her lawful permanent resident status, an added burden is created, because the IRS has a tax regime to tax former citizens (Schneider, 2012:58).

According to section 877 of the IRC (IRS, n.d.), both US citizens that renounce their citizenship and long-term permanent residents that abandon their lawful permanent resident status before 17 June 2008 are liable for taxes for a period of ten years after the renunciation or abandonment. A long-term permanent resident is defined as an alien who has been a lawful permanent resident for eight of the 15 years prior to the abandonment of his/her lawful permanent resident status (Schneider, 2012:58-59).

Various suggestions with regard to worldwide taxation by Schneider (2012:66-67) are summarised below.

- non-resident citizens should not be taxed, and their departure from the US should be treated as a non-event for tax purposes;
- worldwide taxation should continue to be imposed on non-resident citizens for a limited period after their departure, whereafter an exit tax should be imposed if they remain abroad;
- US citizens and lawful permanent residents should be given an opportunity to elect whether to remain US tax citizens or not;
- the tax system that domicile is the deciding factor instead of residence should be amended; and
- an exit tax regime should be implemented.
Taxing non-resident citizens on US source income alone has not been considered in the above suggestions of worldwide taxation. The benefit of citizenship tax would be lost in such a case, because then a person’s residency would have to be defined.

The last suggestion, implementing an exit tax regime, appears to be the most efficient approach. In terms of section 877A of the IRC (IRS, n.d.), all changes in US residence status result in a deemed disposition. It appears that a definition of a resident will be required in this case, resulting in a resident-based tax system. On the day a person emigrates, he/she would be considered to have disposed of most of his/her property at fair market value and to have repurchased the property at the same value immediately thereafter (Schneider, 2012:67).

The many advantages of this exit tax regime include making the US tax system more equitable, and also improving the structure of and compliance with tax laws. Finally, the proposed regime would improve the US international tax policy, and would align the rules for the taxation of non-residents with international tax regimes (Schneider, 2012:76).

### 6.3 COMPARISON

The key terms, income, exempt income and deductions are compared in Tables 6 to 9, overleaf and on the following page.

It should be noted that the income, exempt income and deduction items selected to be compared are items which would commonly occur, and therefore the comparison is not exhaustive. In addition, the items displayed in the tables are taken from a resident’s viewpoint.
Table 6: Comparison of key terms

<table>
<thead>
<tr>
<th>Key terms</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Ordinarily resident</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Resident and ordinarily resident</td>
<td>X</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Resident but not ordinarily resident</td>
<td>X</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Domicile</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Citizen</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Resident alien</td>
<td>X</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Non-resident</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Non-resident citizen</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Non-resident alien</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
</tbody>
</table>


Table 7: Income comparison

<table>
<thead>
<tr>
<th>Income</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services rendered (salaries, wages, bonuses, leave, etc.)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Annuity</td>
<td>✓</td>
<td>✓</td>
<td>X</td>
<td>✓</td>
</tr>
<tr>
<td>Alimony</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Retirement income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Pension income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Provident income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Rental income plant, machinery or buildings</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Dividends</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Interest</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Royalty income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Business income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Capital Gains</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Annual value of house property</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Any form of gambling (lottery and horse racing etc.)</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Gifts</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Job’s seeker allowance (state benefit)</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Life insurance income</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Prizes and awards</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Unemployment income</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>


Notes:
1 – Includes state pensions
2 – Referred to as employment and support allowance (state benefit)
Table 8: Exempt income comparison

<table>
<thead>
<tr>
<th>Exempt Income</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alimony</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Annuity</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Bursaries and scholarships</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Dividends</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Foreign pensions</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Employment abroad</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Pension income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Provident income</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Retirement annuity income</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Interest</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Unemployment insurance benefit</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Leave salary</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Life insurance policy</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Retrenchment compensation</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Income from international sporting event</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>State benefits</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Housing allowance</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>• Maternity allowance</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Interest on state and local bonds</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Gain from sale of principal residence</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Income of states and municipalities</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Disaster relief receipts</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Gifts and inheritance (not employment gifts)</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Foreign earned income exclusion</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
</tbody>
</table>


Notes:
1 – Dividends from domestic companies
2 – Venture capital trust dividends
3 – Non-deductible contributions are not taxable upon exit
4 – Government employee wholly exempt, non-government employee partly exempt
5 – Non-deductible contributions are not taxable upon exit
6 – Government employee wholly exempt, non-government employee partly exempt
7 – Partly exempted
8 – Interest from exempted securities
9 – Employment and support allowance (State benefit)
10 – Partly exempted

© University of Pretoria
Table 9: Deductions comparison

<table>
<thead>
<tr>
<th>Deductions</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension fund contributions</td>
<td>✓</td>
<td>✓</td>
<td>✓¹</td>
<td>✓</td>
</tr>
<tr>
<td>Retirement annuity fund contributions</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Medical aid expenses</td>
<td>✓</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Donations to a public benefit organisation</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Primary rebate</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Secondary rebate</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Tertiary rebate</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Expenses incurred in the production of income which is not capital in nature, e.g. rental expense, telephone, printing, stationery etc.</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Interest payments on loan for higher education</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Higher education expenses</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Rent paid for residential accommodation</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Political party contributions</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Annual house property deductions:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• 30% of net annual value</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>• Interest on borrowed capital</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>• Insurance payments</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>• Repairs</td>
<td>x</td>
<td>✓</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Alimony</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Married couple’s allowance</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Business expenses during job execution</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Professional fees and subscriptions</td>
<td>x</td>
<td>x</td>
<td>✓</td>
<td>x</td>
</tr>
<tr>
<td>Loss from sale of property</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Moving expenses</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Personal exemption</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
<tr>
<td>Standard deductions</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>✓</td>
</tr>
</tbody>
</table>


Note:
1 – Only contributions to personal, company or public service pensions

An example is given below to clarify the concept of the tax base applied in the different countries.

Mr X is employed on a short-term contract basis (varying between 2 to 3 months at a time) by a local company, AB Co Ltd. He has expert knowledge in his field, and when he is between contracts, he travels to Australia and China to render his services to companies that require his skills. Income earned in Australia and China is remitted in those countries.
Mr X owns various properties in his country, and one of them is his principal residence. During the tax year, he sold one of his properties (not his principal residence) and made a loss on the sale. Mr X also owns a holiday villa in Italy, which he leases when he does not occupy it. The rental income earned is paid into Mr X’s local bank account in his country of residence.

In his spare time, Mr X enjoys spending time at a casino and has been quite successful in his winnings. In addition, he earns interest on a fixed deposit at a local bank in his country of residence.

Mr X is currently studying towards his master’s degree and pays monthly interest on the loan he obtained to fund his studies. He is also registered with a professional body and pays annual subscription fees.

Tables 10 to 14 below summarise how the above example will apply in each of the different countries under the various classifications.

**Table 10: Citizen, but not resident, ordinarily resident or domiciled**

<table>
<thead>
<tr>
<th>Item</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (local)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income earned abroad</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Annual house property allowance income</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rental income from Italy</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Gambling profits</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Loss of sale of property</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest on higher education loan deduction</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional fees deduction</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
Table 11: Citizen, resident, ordinarily resident but not domiciled

<table>
<thead>
<tr>
<th>Item</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (local)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income earned abroad</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Annual house property allowance income</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rental income from Italy</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Gambling profits</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Loss of sale of property</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest on higher education loan deduction</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional fees deduction</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

1 - Income taxed on arise basis – income arising in and outside the UK

Table 12: Citizen, resident but not ordinarily resident and not domiciled

<table>
<thead>
<tr>
<th>Item</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (local)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income earned abroad</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Annual house property allowance income</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rental income from Italy</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Gambling profits</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Loss of sale of property</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest on higher education loan deduction</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional fees deduction</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

1 – Does not comply with the foreign income categories displayed in Figure 2
2 – Income earned abroad not paid into the UK bank account, only foreign income paid into UK bank account is taxed (remittance basis)
3 – Rental income earned abroad is paid into the UK bank account (remittance basis)
### Table 13: Citizen, resident, domiciled but not ordinarily resident

<table>
<thead>
<tr>
<th>Item</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (local)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income earned abroad</td>
<td>Yes</td>
<td>No¹</td>
<td>Yes²</td>
<td>Yes</td>
</tr>
<tr>
<td>Annual house property allowance income</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rental income from Italy</td>
<td>Yes</td>
<td>No¹</td>
<td>Yes²</td>
<td>Yes</td>
</tr>
<tr>
<td>Gambling profits</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Loss of sale of property</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest on higher education loan deduction</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional fees deduction</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

¹ – Does not comply with the foreign income categories displayed in Figure 2
² – Income taxed on arise basis – income arising in and outside the UK

### Table 14: Non-citizen and non-resident

<table>
<thead>
<tr>
<th>Item</th>
<th>South Africa</th>
<th>India</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary (local)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Income earned abroad</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No¹</td>
</tr>
<tr>
<td>Annual house property allowance income</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Interest income</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Rental income from Italy</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No¹</td>
</tr>
<tr>
<td>Gambling profits</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Loss of sale of property</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Interest on higher education loan deduction</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Professional fees deduction</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

¹ - The non-resident alien does not have an office in the US that contributes a material factor in the production of income
6.4 SIMILARITIES, DIFFERENCES, ADVANTAGES AND DISADVANTAGES

The ten guiding principles of good tax policy, according to AICPA (2001:14), should be considered in analysing the similarities, differences, advantages and disadvantages of the various tax systems. Incorporating these principles in the comparison of the tax systems takes a country a step further toward ensuring an effective tax system based on good tax practice (AICPA, 2001:14). The ten principles are discussed below:

- **Equity and fairness**
  Taxpayers in similar situations should be taxed equally – this principle is underpinned by the tenets of “equity”. Horizontal equity refers to the principle that taxpayers with the same ability to pay tax should pay the same amount of tax. Vertical equity refers to the principle that taxpayers who have a greater ability to pay should pay more taxes. Many people regard a tax system as fair if those taxpayers with the greatest ability to pay carry the highest tax burdens. However, it should be taken into account that the term “fair” means different things to different people. Hence, to determine whether a tax system is fair, one has to determine whether the tax system is perceived as fair (AICPA, 2001:10).

- **Certainty**
  A person’s tax liability should be certain, rather than ambiguous. This implies that a tax system’s rules have to enable a taxpayer to determine what his/her tax base is – in other words, what nature of transactions are taxed. If a taxpayer can identify transactions subject to tax easily, this adds to the certainty of tax rules. By contrast, if such transactions cannot be identified easily, that does not meet the certainty criterion. Certainty in a tax system helps to improve tax compliance. This principle is also closely related to the principle of simplicity. The more complex a tax system is, the higher the risk that the tax system causes uncertainty (AICPA, 2001:10-11).

- **Convenience of payment**
  Taxpayers should be able to pay a tax when it is most convenient to the taxpayer. This increases compliance with the system. The more challenging it is for a taxpayer to pay taxes, the more likely it is that the taxpayer will not
pay. Payment methods include employers’ withholding taxes from an employee’s salary and provisional payments of estimated taxes (AICPA, 2001:11). This principle is not considered further, as it does not form part of the scope of the study.

- **Economy of collection**
  The cost of collecting taxes should be kept as low as possible for both the taxpayer and the government. The number of revenue officers required to manage the tax collections influences a government’s administration costs. Taxpayers incur compliance costs to ascertain their tax liability and report it. The economy of collecting taxes is linked to the simplicity principle. The more complex the tax system is, the higher the government’s administration costs and the higher the taxpayer’s compliance costs (AICPA, 2001:11).

- **Simplicity**
  Tax legislation should be simple in order for taxpayers to understand the tax rules and comply with them. Simplicity is important to both taxpayers and those who administer the tax system. Complex rules can lead to errors and disrespect for the system. In turn, this can reduce tax compliance (AICPA, 2001:11).

- **Neutrality**
  The influence of tax legislation on a taxpayer’s decisions should be kept to a minimum: tax legislation should not encourage or discourage taxpayers from engaging in certain transactions. The main purpose of a tax is to raise government revenue, rather than influence taxpayers’ decisions.

- **Economic growth and efficiency**
  The tax system should not restrain economic growth and international competitiveness. A tax system aligned with the economic principles and goals of the government imposing the tax should comply with the principles of economic growth and efficiency. Tax rules that might impede this principle include rules that disadvantage a local business compared to a foreign business. In addition, if tax rules favour a given industry, causing labour to flow to such areas, that restrains economic growth and efficiency. This principle is linked to the neutrality principle: tax rules that distort taxpayer behaviour can impede economic efficiency (AICPA, 2001:12).
the study only focuses on tax on individuals, this principle is not considered further.

- **Transparency and visibility**
  Taxpayers must be aware of the types of taxes that exist in a country, and when and how these taxes are imposed on them. Visibility enables taxpayers to identify the true cost of transactions, and to determine their total tax liability (AICPA, 2001:12).

- **Minimum tax gap**
  A tax should be structured to minimize non-compliance. A tax gap arises when there is a difference between taxes owed and taxes actually paid. Such a gap can occur because taxpayers fail to file tax returns, underreport income or overstate deductions intentional errors), or because they make calculation mistakes or fail to understand the rules (unintentional errors) (AICPA, 2001:12).

- **Appropriate government revenues**
  The tax system should be structured in such a way that it enables the government to determine what tax revenue will be collected and when. Tax systems should be predictable and reliable as far as possible to give the government some assurance that its revenue from tax sources will be stable so that it can spend its revenue as required (AICPA, 2001:12).

In reality, all ten principles cannot be achieved to the same degree. For example, excluding a particular type of economic benefit from taxation may satisfy the simplicity rule, but may compromise the equity principle. Thus the application of the ten principles should be carefully balanced to achieve an effective tax system (AICPA, 2001:14).

The similarities, differences, advantages and disadvantages of the tax systems of South Africa, India, the UK and the US are discussed below. Where applicable, reference to the principles of good tax policy is made.
6.4.1 Key terms

The characteristics identified in Table 6 (see chapter 6.3 of this study) are discussed below.

South Africa, India and the UK all use the terms resident, ordinarily resident and non-resident in some form. However, each country uses a different method to determine whether a taxpayer is a resident or ordinarily resident. Similar methods are applied to determine if a person is a non-resident. Each method is discussed briefly below.

According to South African legislation, a taxpayer is a resident of South Africa if he/she is ordinarily resident in South Africa or complies with the physically present test (section 1(a) of the resident definition in the *Income Tax Act, No 58 of 1962* (South Africa, 1962). The term ordinarily resident is not defined in this Act, and case law is relied on to interpret and understand the concept (SARS, 2002:2,4). The disadvantage of this approach is that one has to look at all the surrounding facts to determine whether a person is ordinarily resident, and one cannot merely refer to the tax law. This increases the complexity and uncertainty of the South African tax system, and affects the transparency of the system. The increased complexity could compel a taxpayer to incur additional compliance costs, contravening the principle of economy in collection. Nevertheless, the fact that it is harder to apply the principle of ordinarily resident makes it more difficult to evade tax.

It appears that India’s legislation is more to the point in this regard, and leaves little room for uncertainty. According to section 6(1) of the Indian *Income Tax Act, 1961* (India, 1961), an individual is regarded as an Indian resident in the previous year if he/she was present in India for a total of 182 days or more (condition 1), or if he/she was present for 60 days or more in the previous year, and 365 days or more during four years immediately preceding the previous year (condition 2) This is referred to as the basic conditions.
In addition, if an individual has been resident in India in at least two out of ten previous years immediately preceding the relevant previous year; and for a period of 730 days or more during the seven years immediately preceding the relevant previous year, then he will also be considered ordinarily resident in India (section 6(6) of the Indian Income Tax Act, 1961 (India, 1961)).

The advantage of the Indian tax system is that any ambiguity that could occur in determining being resident or ordinarily resident is eliminated by the set rules embedded in the system. These rules contribute to the simplicity and certainty of the Indian tax system, and ultimately contribute to tax compliance. However, the disadvantage of these rules is that a person could manipulate the rules, for example, by leaving India for a few days to avoid being present in India for the specified 182 days. In this case, the risk of tax evasion is higher, and the tax gap could be increased due to intentional “errors”, so there is a risk that government revenue will decrease. The neutrality principle would also be violated, as the tax rules could influence a taxpayer’s decision to leave India in order to avoid taxes.

In the case of the UK, if a person is present in the UK for more than 183 days, he/she is regarded as a resident of the UK. Only when a person is present for less than 183 days do certain factors, such as intention, duration, frequency, etc. come into play to determine whether the person is a resident (HM Revenue & Customs, 2011:6-7).

According to the UK system, “ordinary residence” is different from “residence”. “Ordinary” indicates that residence is customary, and not accidental. If a taxpayer has always lived in the UK, the person is ordinarily resident in the UK. A person can be a resident, but not ordinarily resident in the UK. A person’s presence, having a settled purpose, regular visits and voluntarily entering the UK are all factors to consider when determining whether a resident is ordinarily resident (HM Revenue & Customs, 2011:9,79).

The UK is the only country that applies the concept of domicile in its tax system. To determine whether a person is domiciled in the UK, reference is made to

© University of Pretoria
general law, and not tax law. Case law is also harnessed to interpret and understand the concept (HM Revenue & Customs, 2011:12).

The treatment of being ordinarily resident and resident as two separate terms increases the complexity of the UK tax system. The UK tax system has an added disadvantage due to its use of the term domicile. To determine a person’s domicile can be challenging (Zelinsky, 2011:1341,1346). This violates the principles of simplicity, certainty, transparency and economy in collection of a tax system.

As discussed earlier, the UK introduced the SRT to determine residency from 2013-2104 onwards. Ashby (2012a) criticises this test, because the terms “home” and “available accommodation” are poorly defined and adds uncertainty to the test. However, the implementation of the SRT appears to be a step in the right direction (Tax Advisor, 2012). With the SRT, the term “ordinarily resident” is disregarded and is replaced with three main steps to determine UK residency. This simplifies and adds to the transparency of the tax system. However, the poorly defined terms “home” and “available accommodation” contribute to the complexity and uncertainty of the UK tax system, which will have an effect on tax compliance.

In respect of the principle of non-residency, all three countries, South Africa, India and UK, apply the same rule. If a person is not resident in that country, he/she is treated as a non-resident of that country.

Even though the US uses different terms from South Africa, the concepts underlying these terms are similar to those applied in South Africa. The Green Card test and substantial presence test (in South Africa, the physical presence test) are applied to determine whether a person is a resident alien of the US (IRS, 2011:4). A person is regarded as a non-resident alien if he/she is neither a US citizen nor a resident alien (IRS, 2012b). This is similar to South Africa, as discussed above, in that a person who is not a resident of South Africa is regarded as a non-resident.
The term “citizen” is unique to the US tax system and is not used by South Africa, India or the UK. The US tax system has an advantage in that clear rules determine the citizenship of a person. Ordinarily resident and domicile are also not considered, which increases the simplicity, certainty and transparency of the US’s system, because the complex rules relating to domicile and being ordinarily resident are avoided.

6.4.2 Income, exempt income and deductions

The similarities and differences shown in Tables 7 to 9 (see chapter 6.3) are discussed below, highlighting the advantages and disadvantages of the respective systems.

6.4.2.1 South Africa

South Africa has similar income categories to those used in India, the UK and the US. The most common items identified are services rendered, pension income, rental income, interest, dividends, business income and capital gains.

Unemployment insurance income is regarded as an exempt income in South Africa, but not in India or the US. Even though this appears to be a disadvantage for the State, it would make sense not to tax this type of income. People receiving an unemployment income are unlikely to be able to afford taxes, and taxation on such an income would be an unnecessary tax burden on the individual and the system. Thus, not taxing such income creates vertical equity and adheres to the principle of equity and fairness. This exclusion contributes to the fairness of the South African tax system, as an unemployed individual has limited capacity to pay taxes. This exception suggests that the other countries are not as well aligned in this regard.

As previously stated in the discussion of the South African tax base in Chapter 4, the international mobility of skilled workers is a sensitive issue for South Africa (OECD, 2004:117). Currently there are an estimated 175 million migrants around the world (ILO, 2013), and therefore the South African tax system’s permitting
employment income from abroad to be exempted adds additional pressure on the tax base. The fact that foreign-sourced pensions are not part of taxable income is a disadvantage to the South African tax system, as it decreases the tax base.

The deduction of retirement annuity fund and pension fund contributions is an advantage of the South African tax system. This deduction encourages taxpayers to save for retirement, resulting in their being self-sufficient and not dependent on the government. Once a taxpayer retires, the retirement and pension lump sum benefit is taxed (however, non-deductible contributions are not taxable upon exit), according to section 1(e) of the gross income definition as per the *Income Tax Act, No 58 of 1962* (South Africa, 1962). This contributes to the fairness of the tax system, because both sides of the coin are covered: the income is taxed and the contributions are deductible.

If one looks at Table 9, which compares deductions, it is noticeable that South Africa’s allowable deductions are limited, in comparison with India, the UK and the US. This is an advantage as well as a disadvantage for the South African tax system. Limiting the allowable deductions increases the tax base and therefore increases government revenue. However, limiting deductions could discourage individuals from registering for tax, resulting in a decrease in tax compliance and ultimately a smaller tax revenue for the State. Also included in the allowable deductions are primary, secondary and tertiary rebates against the individual’s tax payable. South Africa is the only country that allows for these rebates, a disadvantage on the one hand, but an advantage on the other, as this could entice individuals to register for tax, increasing tax compliance and reducing tax evasion.

**6.4.2.2 India**

The main differences between South Africa and India are the annual value of house property inclusion in income. Associated deductions against this income are 30% of the net annual value, interest on borrowed capital, insurance payments and repairs, therefore reducing the income included. The advantage of
this inclusion in income is that it broadens the tax base. The disadvantage is that people would possibly be cautious of buying house properties, as they will be taxed on it, but might not have the funds to pay the tax. Another item to consider is that India allows for rental deductions of residential accommodation. This combination could have a serious effect on the erosion of the tax base, as fewer people would buy properties to avoid the income inclusion – instead they will opt for renting properties, as they would be able to deduct the rent.

Any form of income from gambling and gifts are also included in India’s tax base. India benefits here, compared to South African legislation which excludes gifts, and which includes income from gambling only if the gambling activities formed part of a business or profit-making scheme (Stiglingh et al., 2012:39).

Income from international sporting events is excluded from income in India. The Indian tax system is at a major disadvantage here, as international sporting events have more than doubled from 2009 to 2013 (Christchurch City Council, 2009; Sina.com, 2012). Therefore, this exclusion of income has a direct impact on government revenue.

6.4.2.3 The UK

As Tables 7 to 9 indicate, the income categories, exempt income and deductions in South Africa and the UK are very similar.

The items that attract attention in the deductions table (Table 9) are the deduction of pension fund contributions, professional fees and subscriptions. A person who is employed is liable for a monthly National Insurance Contribution (NIC) to build up the employee’s entitlement to certain State benefits, including the State Pension. The National Insurance Contribution depends on how much the employee earns (HM Revenue & Customs, n.d.(c)). National Insurance Contributions are not allowed as a deduction from income (HM Revenue & Customs, n.d.(c)). Pension income includes state pensions, but the deduction of pension fund contributions only relates to contributions to personal, company and public service pension funds. Just as National Insurance Contributions are
not allowed to be deducted, state pensions are taxed in full. This is an advantage for the UK government, as it increases government revenues, but it could possibly be perceived as a tax system unfair to the individual. For this reason, a taxpayer could decide rather to contribute to a personal pension (as the contributions are deductible) and this option would violate the neutrality principle.

The professional fees and subscription deduction could be appealing to a skilled employee. Even though the deduction decreases the tax revenue, this deduction could entice taxpayers to register with professional bodies, which in return results in taxpayers’ earning higher incomes and paying more taxes, increasing government revenue.

6.4.2.4 The US

The income categories of the US and South Africa are very similar. With regard to exempt income, there are two items that should be highlighted: gains from the sale of a person’s principal residence (applied in South Africa) and the exclusion of foreign earned income (applied in the US).

South Africa is advantaged by including gains from the sale of a person’s principal residence in terms of section 26A of the *Income Tax Act, No 58 of 1962* (South Africa, 1962), as this broadens the tax base and increases government revenue.

The effect of the exclusion of foreign earned income in the US is that if a person is permanently engaged to work as an employee in a foreign country (and he/she complies with the residence or substantial presence test), he/she can elect to exclude a limited amount of the foreign earned income (IRS, 2012a:19). This is similar to the employment abroad exemption used in South Africa. However, the US government benefits more here, as only a limited amount is excluded from income, in comparison with South Africa, where the full amount earned abroad is exempted in terms of section 10(1)(o)(ii) of the *Income Tax Act, No 58 of 1962* (South Africa, 1962). This violates the equity and fairness principle, because a
A taxpayer working abroad is more likely to earn a higher income and this therefore enables him/her to pay the taxes on his/her foreign earned income.

The deductions table (see Table 9) also shows a difference regarding interest payments on loans for higher education, higher education expenses as well as losses from the sale of property. The deduction of higher education expenses could motivate an individual to develop him-/herself, which would result in earning higher income in the long term and could consequently increase tax revenue.

The loss from sale of property has a negative impact on the tax base and could have implications for the neutrality principle. A taxpayer could rather sell property at a loss than at a profit, taking the tax rules into account when making a decision. South Africa has an advantage over the US here, in terms of section 26A of the Income Tax Act, No 58 of 1962 (South Africa, 1962), as only gains from the sale of property are included in income. No reference is made to any loss deductions.

6.5 RECOMMENDATIONS

After analysing the key definitions and tax bases relevant to each country, the following recommendations could be considered to increase the efficiency of the South African tax system, as well as broaden the tax base:

- South Africa should adopt the resident and ordinarily resident rules of the Indian tax system (residents and people ordinarily resident in South Africa would be taxed on their worldwide income); or
- South Africa should adopt the citizen rules of the US system (South African citizens would then be taxed on their worldwide income, irrespective of where the person resides).

Both sets of rules would eliminate the complexity associated with defining South African residency or citizenship.
It is not recommended that South Africa adopt any of the UK rules. Defining ordinarily resident, domicile, home and available accommodation creates additional ambiguity and complexity for the tax system.

The following recommendations regarding income, exempt income and deductions could be considered to broaden the South African tax base:

- include the annual value of house property in income as is done under Indian legislation;
- allow for certain deductions against the annual value of house property to maintain a fair tax system;
- do not allow for the deduction of the rental of residential accommodation;
- include any form of income from gambling in income;
- disregard the employment abroad exemption;
- substitute the employment abroad exemption with the foreign earned income exclusion as under US legislation;
- disregard the foreign pension exemption;
- allow for the deduction of interest payments on loans for higher education as well as higher education expenses; and
- include deductions for professional fees and subscriptions.
CHAPTER 7:
CONCLUSION

7.1 INTRODUCTION

South Africa’s personal income tax reforms over the last few years have not been satisfactory, especially in not sustaining or increasing the government's tax revenue (Steenekamp, 2012:53). Even though SARS (2000b:4) has expressed the opinion that it is essential to refine the tax base on a continuous basis, this has not been done since 2001.

However, the Minister of Finance, Pravin Gordhan, has recently announced that an essential review of South Africa’s tax system will be effected. This review is designed to compare South Africa’s tax system to international standards, to identify initiatives to increase tax compliance as well as defining how to deal with tax base erosion (Ensor, 2013a). The outcome of this review has yet to be seen.

7.2 REVIEW OF RESEARCH FINDINGS

The research objectives of the study were the following:

- to identify the advantages and disadvantages of the various tax systems;
  and
- to suggest improvements and changes to the South African tax legislation.

In the study, literature with reference to the tax base was evaluated. The material consisted of legislation, publications by international organisations and government departments, books, newspaper articles, journal articles, electronic sources and court cases. Once the relevant information had been obtained, a content analysis of the literature was performed to get an understanding of each tax system. Any similarities and differences between the four countries’ tax
regimes, as well as advantages and disadvantages, were highlighted. The key findings are discussed below.

In some instances, South Africa’s tax base has a lot in common with those used in India, the UK and the US. Some items that were worthy of attention were the simple rules used in Indian tax legislation to determine residency and ordinarily resident.

The US citizen rules are yet another way of taxing citizens on their worldwide income without the complexity of determining the resident status of a person. To tax US citizens on their worldwide income, irrespective of whether they are residents or non-residents of the US, appears to be an unfair tax system. However, according to Zelinsky (2011:1291), this is not the case. He is of the opinion that citizenship is nothing else than a proxy for domicile. The US system has the advantage of not referring to domicile, because determining a person’s domicile can pose an overwhelming challenge (Zelinsky, 2011:1341,1346).

An analysis of the tables comparing income (Table 7), exempt income (Table 8) and deductions (Table 9), reveals that each country’s system had both advantages and disadvantages. Specific items that should be highlighted are the advantages of the Indian’s tax system inclusion of the annual value of house property as income.

The international mobility of skilled workers is an increasingly common phenomenon (ILO, 2013), and therefore the exclusion of income earned abroad has a negative effect on the South African tax base. The foreign earned income exclusion of the US system appears to be a better option in this situation.

It was also determined that permitting some deductions would both decrease and increase the tax base. These deductions are higher education expenses as applied in India and the US, as well as professional fees and subscription fees as applied in the UK. Even though these deductions decrease the tax base in the short term, these deductions could entice taxpayers to develop themselves, as well as register at professional bodies. By doing this, a taxpayer will earn higher
income, resulting in more tax for the government in the longer term. In addition, the deductions also motivate taxpayers to register for tax, resulting in an increase in tax compliance, a decrease in tax avoidance and ultimately an increase in revenue.

7.3 CONCLUDING REMARKS

The review of the tax base of the different countries was very insightful, as various elements that influenced the tax base have been identified. A country cannot analyse the income, exempt income and deductions elements in isolation, but should also consider the effect that these elements have in terms of the ten principles of good tax policy as listed by the AICPA.

The South African tax system is currently under review, which suggests that the government realizes the importance of the progressivity of the tax system. Until the outcome of the review is determined, South Africa could consider adopting some of the advantages of the various countries’ tax systems. This would result in a bigger tax base, increasing the government’s tax revenue and supporting their spending needs.

7.4 FUTURE RESEARCH

Some possibilities for future research that emerge from this study include the following:

- determining the effect of the various countries’ tax rates on their tax base;
- reviewing approaches suggested by the OECD for taxing personal income and the effect thereof on the tax base; and
- analysing the outcome of the proposed review initiated by the South African government and the result thereof on the tax base.
LIST OF REFERENCES

AICPA - see American Institute of Certified Public Accountants


*CIR v Kuttel*, 1992 (3) SA 242 (A) (54 SATC 298).
CIR v Lever Brothers & Unilever Ltd (1946 AD).

Civil Engineer v IRC (2002) (STC (SCD) 72).

Cohen v CIR, 1946 AD 174 (13 SATC 362).

Commissioners of Inland Revenue v Zorab (1926) 11 TC 291.

Commissioner v. Swent [46-1 USTC 9266], 155 F. 2d 513, 272 F. 2d 709, c.d. 329 U.S. 801.

de la Begassiere v. Commissioner [CCH Dec. 23,466], 31 T. C. 1031.


Fuller v. Hofferbert [53-1 USTC 9405], 204 F. 2d 592 (6CCA).


ILO – see International Labour Organization


*Inland Revenue Commissioners v Bullock* (1976) 414d.


IRS – see Internal Revenue Service


*Levene v Inland Revenue Commissioners* (1928) 13 TC 505.

*Lysaght v Commissioners of Inland Revenue* (1928) 13 TC 511, 529.

© University of Pretoria


NEPAD-OECD – see New Partnership for Africa’s Development-Organization for Economic Co-operation and Development


OECD – see Organisation for Economic Co-operation and Development


SAICA – see South African Institute of Chartered Accountants

SARS – see South African Revenue Service


*Thompson v Minister of National Revenue*, 2 DTC 812 (SCC).


*Udny v Udny* (1869) L R 1 SC & Div 441.

UK – see United Kingdom


US Code – see United States Code
