STANDING COMMITTEE ON FINANCE

TECHNICAL SUBMISSION

Submitted by

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SUBMISSIONS IN RELATION TO THE 2020 DRAFT TAXATION LAWS AMENDMENT BILL AND TAX ADMINISTRATION LAWS AMENDMENT BILL

A. PREAMBLE

On 31 July 2020, the National Treasury and the South African Revenue Service ("SARS") published, for public comment, the 2020 draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, the 2020 draft Taxation Laws Amendment Bill ("draft TLAB") and the 2020 draft Tax Administration Laws Amendment Bill ("draft TALAB").

Pursuant to the publication of the draft Bills, we hereby submit our comments and wish to address the Standing Committee on Finance in respect of the below specific proposed amendments, under the draft TLAB and the draft TALAB.

B. DRAFT TLAB

1. Withdrawal of retirement funds upon emigration

1.1. Background

1.1.1. The Income Tax Act No. 58 of 1962 ("the ITA") defines "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 thereof.

1.1.2. In their current form, each of these definitions contain a proviso, which determines that a member of these funds shall be entitled to withdraw the underlying retirement benefits prior to their retirement date where that member –

> *"is a person who is or was a resident who emigrated from the Republic and that emigration is recognized by the South African Reserve Bank for purposes of exchange control"*

1.1.3. The law has undergone some development, but in principle this concession was first introduced with the Taxation Laws Amendment Act No. 3 of 2008. The Explanatory Memorandum accompanying the relevant Bill provided the following explanation for its introduction:

> *"**Withdrawals where a member emigrates***
>
> *<u>Current Law</u>*
>
> *Members of a retirement annuity fund may not withdraw their funds prior to retirement except where the value is very small.*
>
> *<u>Problem Statement</u>*
>
> *Where members of a retirement annuity fund emigrate before retirement, those members are unable to withdraw their funds until such time as they retire (which may be many years into the future).*
>
> *<u>Proposal</u>*
>
> *It is proposed that the Act be amended to allow members who emigrate from South Africa before they retire to withdraw their funds prior to retirement, provided they pay the full tax on the benefit."*

1.1.4. On the strength of these provisos, which read the same for each definition, members of retirement funds are permitted to withdraw their retirement benefits upon completion of a process of emigration recognized by the South African Reserve Bank ("the SARB"). This process is commonly referred to in the market as "financial emigration".

1.2. Proposed amendment

1.2.1. Paragraphs (h), (k) and (m) of section 2(1) of the draft TLAB proposes the following amendment to the proviso of the definition of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 of the ITA:

> *"is a person who is **[or was]** not a resident **[who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control]** for an uninterrupted period of three years or longer"*

1.2.2. The Explanatory Memorandum to the draft TLAB expounds the rationale for the proposed amendment as follows:

> *"**II. Reasons for change***
> *As outlined in Annexure E of the 2020 Budget Review, Government will be modernising the foreign exchange control system. As a result, a new capital flow management system will be put in place. This new system will move from a "negative list" system to one where all foreign-currency transactions, other than those contained on the risk-based list of capital flow measures, being allowed.*
>
> *In respect of individuals, one of the changes to be implemented during modernisation of the foreign exchange*

control system is the phasing out of the concept of "emigration" for exchange control purposes. The phasing out of this concept will have a direct impact on the application of the tax rules as the tax legislation makes provision for a payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes.

III. Proposal

In order to ensure efficient application of the tax legislation, it is proposed that the definitions of "pension preservation fund", provident preservation fund and "retirement annuity fund" in section 1 of the Act be amended to remove the reference to payment of lump sum benefits when a member emigrates from South Africa and such emigration is recognised by the SARB for exchange control purposes. As such, a new test should be inserted which will make provision for the payment of lump sum benefits when a member ceases to be a South African tax resident (as defined in the Act), and such member has remained non-tax resident for at least three consecutive years or longer.

IV. Effective date

The proposed amendments will come into operation on 1 March 2021."

1.2.3. Therefore, the proposed amendment removes reference to the financial emigration process and replaces it with a new test, which effectively requires the taxpayer who wishes to withdraw their retirement benefit to prove they have been non-resident for an uninterrupted period of at least three years.

1.2.4. The Explanatory Memorandum cites a change in exchange control policy as the reason for the proposed amendment. More specifically, the change is a result of the "modernisation of the

foreign exchange control system".

1.2.5. In this regard, Annexure E to the 2020 Budget Review makes the following statement:

> *"In this context, the National Treasury proposes modernising the foreign-exchange system. Since 1933, South Africa has operated a "negative list" system. By default, foreign-currency transactions are prohibited, except for those listed in the Currency and Exchanges Manual. As a result, even small individual transactions – such as for travel – require onerous approval processes. This regime constrains trade and cross-border flows, particularly in relation to fast-growing African economies.*
>
> *Over the next 12 months, a new capital flow management system will be put in place. All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures summarised in the box overleaf. This change will increase transparency, reduce burdensome and unnecessary administrative approvals, and promote certainty."*

1.2.6. Annexure E further notes that *"Under the new system, natural person emigrants and natural person residents will be treated identically".*

1.3. <u>Amendment at variance with its purpose</u>

1.3.1. The cited purpose behind the proposed change is to move to a more modern exchange control system that is less restrictive in terms of foreign-currency transactions. In terms of Annexure E to the 2020 Budget Review, government seeks to reduce the burden of obtaining exchange control approval and to adopt a system that is more transparent and certain.

1.3.2. This policy change is one we support; however, the new proposed test to withdraw retirement benefits in this context is at cross-purposes with the objective of a more modern exchange control system.

1.3.3. The current dispensation permits immediate withdrawal when a taxpayer financially emigrates, a proven process that is effective while ensuring proper checks and balances from a tax and exchange control perspective.

1.3.4. Under the new test, retirement benefits will effectively be locked-in and will be inaccessible to the individual in question for a minimum period of three years, even after they have left South Africa permanently. This restriction will only be lifted once the taxpayer in question is able to prove they have been non-resident for an uninterrupted period of at least three years.

1.3.5. By any measure, this new test is the opposite of “modernisation” and a step back towards locking in retirement funds after becoming non-resident for tax and exchange control purposes.

1.3.6. Furthermore, if the test is to be based on residency, it is not clear why withdrawal is subject to a period of three full years. If the taxpayer has ceased residency, why impose a punitive lock-in of this extent? Seemingly, this may be an anti-avoidance measure to prevent taxpayers from emigrating under false pretenses. In other words, it mirrors the current practice, to an extent, where a taxpayer is required to return all funds expatriated if they permanently return to South Africa within five years of completing their emigration through the SARB. However, this would still not justify the lock-in period because the requirement to declare a failed emigration is based on exchange control regulations that applied historically, where individuals “emigrated” to circumvent the restrictions of the time. Based on the current exchange control regulations and the touted dispensation where there will

be no restrictions, there is no need for such a measure.

1.3.7. Moreover, the proposed test, by virtue of the manner in which residency is determined under the ITA (as outlined in the paragraphs that follow), would occasion far more uncertainty than the current process.

1.3.8. In summary, the proposed amendment would do away with a well-established process that allows emigrants to freely expatriate their retirement benefits with one that is far more restrictive and less transparent.

1.3.9. Therefore, this amendment cannot be reconciled with the objectives outlined in Explanatory Memorandum and the Budget Review.

1.4. Proving non-residency

1.4.1. Based on the proposed wording of the proviso, it is not specified which residency test would be applicable or how the application thereof must be proven.

1.4.2. Under our domestic law, residency can be established in terms of two tests i.e. the ordinarily resident test and the physical presence test (the DTA position is discussed below). The ordinarily resident test is applied first and would be the test that for the far majority of cases finds application where a taxpayer seeks to withdraw their retirement benefits under the provisos in question.

1.4.3. The ordinarily resident test is by its nature an exhaustive exercise that can only be conducted by objectively assessing if the taxpayer's factual matrix supports an espoused intention of leaving South Africa permanently.

1.4.4. This raises the question of how a taxpayer must prove their non-residency, as envisaged by the proposed amendment? It is inconceivable that the SARB or SARS would make an objective determination of residency based on an assessment of the taxpayer's facts. This would impose an immense administrative burden on the institution, which is why SARS is notoriously reluctant to make a formal determination of a taxpayer's residency in the form of, for example, a ruling.

1.4.5. With the Explanatory Memorandum offering nothing on the practicalities, the only plausible method of application would be to verify if the taxpayer indicated on their tax return that they ceased residency during an earlier year of assessment, as per the below excerpt:

1.4.6. If the tax return is the only accepted mechanism of proving this, it would mean the application of the proviso would be overly formalistic.

1.5. <u>Residency under DTAs</u>

1.5.1. It is important to note that one can cease residency where the individual in question is found to be resident of another state by application of a double tax agreement ("DTA"), even if they meet the requirements of the ordinarily resident test. We believe it would be prudent for National Treasury to request from SARS (a)

how many individual taxpayers have actually claimed this basis of non-residency in their personal income tax filings, and (b) how many audits were done by SARS on these disclosures actually requesting said double tax agreement jurisdiction's 'tax residency certificate (or equivalent). We have our prediction what this will show on tax leakage, but let the numbers speak for themselves.

1.5.2. Practically, this means an individual who works in a foreign country for a period of three years would be able to withdraw their retirement benefits, even if they have the intention to return to South Africa permanently once their assignment concludes.

1.5.3. On the other hand, a taxpayer who has left the country permanently but who have not yet noted a cessation of residency on their tax return may be precluded from doing so.

1.5.4. As such, the proposed test does not guarantee an alignment with a taxpayer's factual reality. The test may be too lenient on those who should arguably not be sanctioned to expatriate their retirement funds, whilst being oppressive with respect to individuals whose facts permit such expatriation.

1.5.5. In terms of the currently proposed wording, no distinction is made in terms of how residency must be determined, which may yield distorted outcomes, as described hereinbefore.

1.6. <u>Transitional arrangements</u>

1.6.1. The Explanatory Memorandum is also silent on the migration to the new system. For example, it must be clarified if individuals who have initiated the financial emigration process before the effective date of 1 March 2021 will be permitted to expatriate their retirement funds under the old dispensation.

1.6.2. The alternative is that if the financial emigration process is not yet finalized by 1 March 2021, the applicant will be subject to the new test. However, we submit this would be inequitable.

1.7. Conclusion

1.7.1. It is submitted that the proposed test based on residency flouts the purported objectives of the amendments. We accept that government's aim is to move away from a residency system for exchange control purposes, but as we have shown this is questionable methodology and a seemingly conflicting result is achieved.

1.7.2. Clarity must be provided on which tests for residency will be applicable for purposes of the proviso, or whether simply ticking the box of non-residency is acceptable.

1.7.3. The position on split year treatment of tax residency must be addressed.

1.7.4. Guidance should be given on how the new test will be phased in where the taxpayer initiated the financial emigration process prior to the effective date.

C. DRAFT TALAB

2. Tax offences

2.1. Background and proposed amendment

2.1.1. It is proposed that sections 8, 21 and 34 of the draft TALAB amend paragraph 30 of the Fourth Schedule to the ITA, section 58 of the Value-Added Tax Act No. 89 of 1991 and section 234 of the TAA respectively.

2.1.2. The amendment in respect of each of these provisions are identical and proposes substitution of the current wording as follows:

> "Any person who [wilfully and] without just cause—"

2.1.3. The proposed amendment seeks to remove reference to "willfully", as it imposes the requirement of intent, thereby excluding negligence as a form of fault in committing a tax offence.

2.1.4. The Explanatory Memorandum provides the following reason for the change:

> *"The National Prosecuting Authority (NPA) is of the view that the current wording relating to criminal offences substantially undermines the ability of SARS to ensure compliance based on the objective standard expected of the reasonable person. Consequently this may hamper the criminal prosecution of noncompliant taxpayers by the NPA in seeking to prove the elements of the crime.*
>
> *For this reason it is proposed that the requirement of wilful conduct be removed with regards to criminal offences in the wording of the statutory offence. This will enable the NPA and SARS to measure a taxpayer against such objective standards where required."*

2.2. <u>Comment</u>

2.2.1. There have been calls from many quarters that firmer action is required as far as tax offences are concerned; specifically, that taxpayers who flout their tax obligations must face criminal prosecution.

2.2.2. We agree with these calls and we principally agree with the notion that SARS must be given the necessary tools to improve its deterrence factor.

2.2.3. Therefore, we are not opposed to the proposed amendment per se, but there is no doubt there will be strong opposition to this amendment and we are concerned that it may not pass muster, particularly from a constitutional perspective.

2.2.4. We note that the Explanatory Memorandum states that the current wording purportedly makes it too difficult for SARS and the National Prosecuting Authority (NPA) to prove the elements of the crime, which is why the proposed amendment is introduced.

2.2.5. This may be the case, but we are not aware of any cases or statistics that support this averment. If such statistics exist, they are not shared, and the public is kept in the dark in general when it comes to the prosecution of taxpayers.

2.2.6. We therefore request that SARS and the NPA provide the statistics behind the proposed amendment. We specifically request that SARS and the NPA share the number of cases that are referred to the NPA by SARS, the number of cases pursued by the NPA following such referrals, the relevant cases where convictions were not possible because the elements of the crime could not be proven, as well as any other statistics that may be relevant.

2.2.7. Whilst we are not opposed to the amendment in principle, we submit it would be difficult to argue why this amendment is reasonable and justifiable, based on the submissions in the Explanatory Memorandum, where said submissions cannot be substantiated with concrete statistics and examples.

2.2.8. We therefore implore SARS and the NPA to share this with stakeholders when the public's comments are dealt with during the Parliamentary hearings.

D. CONCLUSION

3. We humbly request that the Standing Committee on Finance and SARS consider the above submissions and, should supplementary argument be required thereon, please advise accordingly.

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