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Withdrawing retirement funds on emigration: The impact of the Taxation Laws Amendment Act

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As currently worded, the definitions of pension preservation fund, provident preservation fund and retirement annuity fund in section 1 of the Income Tax Act, 1962, make provision for a payment of lump sum benefits when a member of a pension preservation, provident preservation or retirement annuity fund withdraws from the retirement fund due to that member emigrating from South Africa, which emigration is recognised by the South African Reserve Bank (Sarb) for exchange control purposes.

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The Taxation Laws Amendment Act No. 23 of 2020 (TLAA), published in the *Government Gazette* on 20 January 2021, has however amended these definitions to remove the reference to such emigration being recognised by Sarb and replaced it with a new test.

With effect from 1 March 2021, the new test makes provision for the payment of lump sum benefits when a member ceases to be a South African tax resident as defined in the Income Tax Act, and such member has remained a non-resident for an uninterrupted period of three years or longer.

The reason for the change

Before going any further, let’s start off with unpacking the background in order to add context before delving into the details of this change.

As outlined in the 2020 Budget Review, the government intends to modernise the foreign exchange control system. In respect of individuals, one of the changes to be implemented 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 currently makes provision for a payment of lump sum benefits when a member emigrates from South Africa on the condition that such emigration is recognised by the Sarb for exchange control purposes. Hence the amendments to the Income Tax Act as discussed herein.

Amendments to Section 1 of the Income Tax Act

The TLAA has amended the definitions of pension preservation fund, provident preservation fund and retirement annuity fund as set out in section 1 of the Income Tax Act to remove the reference to emigration as recognised by the Sarb for exchange control purposes.

Instead, these definitions now refer to a new test which makes provision for the payment of lump sum benefits when a member ceases to be a South African tax resident as defined in the Income Tax Act, and such member has remained a non-resident for an uninterrupted period of three years or longer.

Who is regarded as a non-resident?

South Africa has a residence-based tax system, which means residents are, subject to certain exclusions, taxed on their worldwide income, irrespective of where their income was earned. By contrast, non-residents are taxed on their income from a South African source.

Since tax systems differ from country to country, there is a chance that a particular amount could be taxed twice. This possibility of double taxation is, however, often alleviated by tax relief contained in various double taxation agreements (DTAs). These DTAs are international agreements contracted between countries to deal with potential competing taxing rights against the income of the same taxpayer.

Under the provisions of the DTA, the non-resident's remuneration earned in South Africa may not be subject to normal tax in South Africa where specific requirements are met.

The Income Tax Act does not define a non-resident, so in order to determine who would be regarded as a non-resident we have to start with looking at the definition of resident as set out in section 1 of the Income Tax Act.

A resident refers to any natural person:

- who is ordinarily resident in the Republic; or
- who complies with all the requirements of the physical presence test.

There are thus two tests to determine whether a person is a resident for tax purposes:

- the ordinarily resident test; and
- the physical presence test.

The ordinarily resident test is fairly self-explanatory: a person is ordinarily resident in SA for tax purposes if SA is his/her usual/principal residence.

A person who is not ordinarily resident in the republic may still qualify as a resident for tax purposes if the requirements of the physical presence test are met. The physical presence test, also known as the day test or time rule, is based on the number of days that a natural person is physically present in the republic. The purpose or nature of the visit is irrelevant. It must be determined annually whether all the requirements of the physical presence test have been met.

To meet the requirements of the physical presence test, that person must be physically present in the countryfor a period or periods exceeding:

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

If that person fails to meet any one of these three requirements, he/she will not satisfy the physical presence test.

If the person is neither ordinarily resident, nor meets the requirements of the physical presence test, that person will be regarded as a non-resident for tax purposes. This means he/she will be subject to tax only on income that has its source in South Africa.

Conclusion

Despite previous submissions by Association for Savings and Investment South Africa (Asisa) and the Institute of Retirement Funds Africa (Irfa) on the TLAA when it was still in draft bill form, Treasury pushed ahead with the three-year tax residency test as discussed above. While these amendments come into effect on 1 March 2021, emigration applications could still be made at Sarb until 28 February 2021 and be approved by Sarb or an authorised dealer on or before 28 February 2022.

Lastly, the requirement for those who are in South Africa and not regarded as residents and who are in the country on a visa can still withdraw their fund interest when they depart from South Africa when the visa expires.

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