An international comparison of the South African tax treatment of cross-border retirement fund payments

C Mans

orcid.org/0000-0002-7138-3374

Mini-dissertation accepted in partial fulfilment of the requirements for the degree Master of Commerce in Taxation at the North-West University

Supervisor: Prof P van der Zwan

Graduation: June 2021

Student number: 25882562

ABSTRACT

South Africa adopted the residence tax base in 2001, which means that residents are taxed on worldwide income and non-residents are taxed on South African source income. With cross-border retirement benefits, South Africa deviates from this tax base, since it provides relief to residents for foreign retirement benefits, which can lead to South Africa losing tax revenue on this income. This mini-dissertation had the aim to compare the South African tax treatment relating to cross-border retirement benefits with those of international policies, such as the policies from Model Tax Conventions and tax treatment of overseas countries' tax legislation.

The South African tax system has seen many changes, especially when it comes to the cross-border retirement benefits. South Africa taxes residents on retirement benefits, but provides an exemption for foreign retirement benefits. Non-residents are taxed based on the location of the services rendered as well as the payment being made from a South African fund. This indicates that for retirement benefits, South African tax legislation deviates from the residence based principle of taxation, especially for residents since they are only taxed on South African sourced retirement benefits. A comparison should be done on how the current South African tax treatment of cross-border retirement benefits compare to those of other comparable countries and international practice.

The OECD has the preferred view that the country of residence should have the taxing right, which shows that South Africa's tax treatment is not entirely in line with the OECD, since residents are not taxed on receipts from foreign funds. The United Nations, however, prefers that the source country should have the taxing right and South Africa's tax treatment is more in line with the United Nations' view, since it taxes residents and non-residents when the retirement benefit is from a South African source. When compared to other countries, South Africa has a more lenient tax treatment for residents, giving them exemption for foreign retirement benefits, where other countries aim to tax their residents on the foreign retirement benefits, which indicates the research problem that South Africa deviates from the residence-based tax principle.

South Africa has a source based tax treatment for non-residents, taxing them on retirement benefits when the services were rendered in South Africa, and when the fund is located in South Africa. Other countries aim to only tax non-residents when a fund in that country pays the benefit or not to tax non-residents at all. All of these tax treatments are subject to specific double tax agreements.

It is clear that South Africa has a unique tax system when it comes to cross-border retirement benefits, where only certain elements of the tax treatment were comparable to international trends and practices. The main differences are that South Africa does not aim to allow the country of residence to have the sole taxing right over retirement benefits, since it does not tax residents on worldwide retirement benefits. South Africa provides relief to its residents for foreign retirement benefits and specifically looks at the services rendered in South Africa for non-residents. Because of the lenience towards residents, South Africa is losing tax revenue which can be problematic for the fiscus. The current tax position in South Africa was compared to international trends, however was found to not be closely aligned to the OECD's preferred view, but rather to the United Nations' view. A conclusion was drawn that South African tax legislation should be amended to tax cross-border retirement benefits in order to be aligned with the residence-based principle

Key terms: tax treatment, retirement fund, retirement benefits, cross-border payments, international policies, country of residence, source of income.

DEDICATION

I dedicate this mini-dissertation to my grandparents, Pietie and Myrna Pieterse, who have been married for 60 years in 2020. They overcame many health challenges during 2020 and continue to be my greatest inspiration. Their love for God and their family is what keep us all together.

ACKNOWLEDGEMENTS

This mini-dissertation will not have been possible without the help and support of many people.

First and most important of all, to my Heavenly Father. I will not be where I am today it if wasn’t for Your love and mercy throughout my life. *Gloria in excelsis Deo.*

To my supervisor, Prof Pieter van der Zwan. Thank you for all the comments and review notes and for going through a lot of trouble in providing me with sufficient and timely feedback. I have learnt a lot from you and I am privileged to have been a student of yours.

To my fiancé, Hanru de Vos, for your continued patience, sacrifices and support. This would not have been possible without you. I love you.

To my parents, Andries and Myrtle Mans, for always being there for me and believing in me. Your daily phone calls, food parcels and continued love and support kept me going every day. Thank you for always going out of your way to help me.

To the Potgieter family – Lizette, Jacques, Xander and Xayden – for always being there for me and believing in me.

To my employer and engagement team, thank you for providing me with sufficient study leave and support to complete this mini-dissertation.

To Anelle Venter, thank you for the language editing and for being a great friend and fellow wine-lover.

To the rest of my family and friends, thank you for all your support!

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CHAPTER 1 INTRODUCTION

1.1 Background to the research area

Most South Africans do not make sufficient provision for their retirement (Nelson, 2016). With technology improving and the increasing mobility of people, companies can expect their employees to work from outside their country of residence, or employees can choose to do so themselves (Sunjka, 2020). This cross-border element of such persons' retirement benefits can have an impact on the way that the residence country or source country tax the retirement benefits upon their retirement.

In 2000, a former Minister of Finance of South Africa, Trevor Manuel, announced that for tax years commencing after 1 January 2001, the tax system of South Africa will move from a source principle to a residence-based income tax for South African residents to be more in line with international practice (Manuel, 2000). This meant that South Africa levied tax on residents on their worldwide income, instead of levying tax on income earned from a source within South Africa. Consequently, this change in tax base also had an influence on how residents of South Africa are taxed on their income, since they will be taxed on their income regardless of where it is earned (Padayachee *et al*., 2001:1357). This consequently also had an impact on how South Africa taxes residents on their retirement income.

Retirement income comes from retirement funds, such as a pension fund, pension preservation fund, provident fund, provident preservation fund and a retirement annuity fund. *The Pension Funds Act* 24 of 1956 defines a pension fund organisation as an association of persons engaged in any occupation with the objective to provide benefits for its members or former members upon retirement. An employee, and/or sponsors, like the employer, contribute to a pension fund and subsequently receives fixed payments after the employee retires (Consigli *et al.,* 2017).

Furthermore, an employer can set up a provident fund for the advantage of its employees in order to provide them with a lump sum upon retirement (Godden, 2010:24). It is similar to pension funds, in terms of the fact that it forces an employee to save for future retirement. A retirement annuity fund is also set up to provide income to its members upon retirement, given that the member is 55 years of age. A retirement annuity fund is however not linked to an employer and is often used by self-employed people or people who wish to make additional provision for retirement (Godden, 2010:24). Pension funds, provident funds and retirement annuity funds will hereafter collectively be referred to as "retirement funds" because the taxation of these funds are similar.

In South African tax legislation there are rules set out for the taxation of retirement benefits. For tax residents of South Africa, payments received from South African funds are included in gross income in terms of paragraph *(e)* of the gross income definition in section 1 of the *Income Tax Act*, 58 of 1962 (hereafter the *Income Tax Act*). These payments are taxed under the retirement fund lump sum benefit table and are not subject to normal tax thresholds. Payments received from foreign retirement funds are also included in gross income, since South Africa taxes residents on their worldwide income. This amount will however be exempt from tax in terms of section 10(1)(*gC*)(ii) of the *Income Tax Act* if the payment is from a source outside the Republic as consideration for past employment outside the Republic. This exemption will however not apply to payments from local funds as defined in section 1(1) of the *Income Tax Act.*

For non-residents for tax purposes, payments from South African funds will be included in the gross income of the non-resident in terms of the section 1 gross income definition, which states that South Africa taxes non-residents on income from a source in the country. Section 9(2)(*i*) of the *Income Tax Act* states that an amount is received by or accrues to a person from a source within the Republic if that amount constitutes a lump sum, pension or annuity payable by a fund and the services in respect of which that amount is so received, were rendered within the Republic. Payments to non-residents resulting from services rendered outside South Africa will not be taxable, since it is not from a source within South Africa. Therefore, South Africa taxes non-residents on retirement benefits if the non-resident rendered the services in South Africa and a fund in South Africa makes the payment to the non-resident. The services rendered in South Africa seems to be the deciding factor on whether the payment is from a source in South Africa. The tax treatment between residents and non-residents for cross-border retirement benefits therefore show similarities, such as the fact that the location of the fund plays a role in determining the tax treatment. The tax treatment between residents and non-residents also has differences, such as the fact that the deciding factor between residents and non-residents are not the same. The way in which South Africa taxes residents and non-residents also differ since the tax bases are worldwide income and income from a South African source respectively.

1.2 Motivation of topic actuality

According to Brewster *et al.* (2019), people find it much simpler nowadays to find jobs internationally as the market to find jobs has become larger and accessible. There are many people who look beyond their country of birth or residence for career opportunities. This has an effect on the taxation of such taxpayers, because South Africa taxes residents for tax purposes on worldwide income and non-residents on South African source income. Amendments made to section 10(1)(*gC)* of the *Income Tax Act* in recent years, reveals the relevancy of the taxation of cross-border payments from retirement funds.

The National Treasury considers international policies and legislation to determine South African tax policy (National Treasury, 2019). It is therefore useful and important to know what the tax position of other countries and international tax policies are in order to determine how South Africa compares to these policies. The comparison can then be applied to cross-border retirement benefits to determine how the South African tax treatment compares to international policies.

The basic available literature on the topic is the *Income Tax Act* of South Africa. This Act sets out how South Africa taxes payments from retirement funds. The preferred view and policies in Model Tax Conventions as well as the tax legislation of other countries are also available. The National Treasury and other authors have issued many publications regarding the taxation of cross-border retirement fund benefits. Studies have been done where an international comparison is made regarding the tax implications of cross-border retirement benefits. The Organisation for Economic Co-operation and Development regularly undertakes similar studies. Limited information, such as studies and articles, is however available regarding how South Africa's tax treatment compares to those of other countries for the cross-border tax treatment of retirement fund benefits, which is an incentive for this study. Research done in this study aims to fill that gap.

1.3 Problem statement and research question

Residents of South Africa for tax purposes are taxed on worldwide income, yet the net effect of the current cross-border retirement payments is that residents are only taxed on South African sourced income. For cross-border payments, the country where the fund is located will be entitled to the tax income if the services were rendered in that country. However, for non-residents for tax purposes, South Africa taxes the payments from retirement funds if the fund is located in South Africa as well as if the person rendered the service in South Africa. It seems that for non-residents, the benefit from the retirement fund will be from a South African source if the services were rendered in South Africa and the fund is located in South Africa.

The above indicates that South Africa does not tax cross-border retirement benefits according to the residence-based tax system adopted in 2001, where residents are taxed on worldwide income. There is thus a possibility that foreign retirement benefits received by residents are not taxed at all. This can indicate that the South African tax system is not aligned with international tax systems and policies. This can also lead to South Africa losing tax revenue from these cross-border retirement benefits. The question that arose is: how does the current South African tax treatment of cross-border payments received from retirement funds compare to those of other comparable countries and international practice?

1.4 Objectives

The following objectives were formulated and addressed in this study:

1.4.1 Main objective

By doing an international comparison of selected countries and international practice, the main objective was to analyse the South African tax treatment for cross-border lump sum and other payments from retirement funds and to determine how they compare to international policies and tax treatment.

1.4.2 Secondary objectives

In order to accomplish the main objective, the following secondary objectives were formulated:

- To analyse the development of the South African tax legislation with regard to lump sum and other payments from retirement funds. This analysis was done from 2001, when South Africa moved from a source based to a residence based tax system, up until the most recent amendments (addressed in Chapter 2);
- To analyse the taxation policy as set out in the double tax agreement model of the Organisation for Economic Co-operation and Development (hereafter the OECD) and the United Nations (hereafter the UN) with regard to the tax treatment of cross-border payments from retirement funds and to compare it to South Africa's tax treatment (addressed in Chapter 3); and
- To analyse the tax treatment of developed countries (such as Australia, Canada, New Zealand, and the United Kingdom) with regard to the tax treatment of cross-border payments from retirement funds and to compare it to South Africa's tax treatment of similar payments (addressed in Chapter 4).

1.5 Research design and method

1.5.1 Paradigmatic assumptions and perspectives

According to Yilmaz (2013:1), researchers in every discipline need to be aware of different research methods in order to make a decision about which method to use during studies. Two major approaches to research are qualitative and quantitative research.

First of all, a researcher should make a distinction between qualitative and quantitative research. Qualitative research has a focus to understand research in a humanistic or idealistic approach and it generates non-numerical data, whereas quantitative research is based on numeric data and can be done objectively (Pathak *et al*., 2013:1). In this study, a qualitative approach was followed since no numerical data was used to do the research and a qualitative comparison was made.

1.5.1.1 Ontological assumptions

According to McKerchar (2008:6) ontology is how the researcher views the world. The Oxford English Dictionary defines ontology as the "science or study of being" concerned with the "nature or essence of being or existence" (Oxford University Press, 2020). This is therefore the nature of the reality in which the researcher finds himself.

Interpretivism assumes that the researcher cannot detach himself from the subjects being studied (McKerchar, 2008:7), in other words the world does not exist independently of our knowledge of it. With taxation, an interpretivistic approach is followed, since the tax principles do not exist independently of our knowledge thereof. The interpretivist researcher will most likely use qualitative methodology, which was used in this study.

Taxation legislation is subject to interpretation and not all researches will observe it in the same way. The interpretation of the *Income Tax Act* and the taxation legislation of other countries was therefore studied by using an interpretivistic approach. Tax legislation and amendments thereto were obtained and interpreted to come to a conclusion.

1.5.1.2 Epistemological assumptions

Epistemology is how a researcher believes that knowledge is created (McKerchar, 2008:6), which can be subjective or objective. The Oxford English Dictionary defines epistemology as the "theory of knowledge and understanding" (Oxford University Press, 2020). The researcher therefore interacts with the data and information he researched.

A researcher needs to identify how knowledge of the topic being researched has developed. In this study, consideration was given to where the current legislation comes from and how it developed over the years. An international comparison between South Africa's and other countries' tax legislation was also made. The similar sections in other legislations were studied and interpreted. This study aimed to answer the objective whether South Africa's tax treatment with regard to payments from retirement funds is in line and comparable with those of other countries. Because of the closeness of the researcher to the research subject, the researcher cannot be objective.

1.5.1.3 Methodological assumptions

Methodology is the research strategy that shapes the way a researcher undertakes a research project (Howell, 2013). First of all, the development of South Africa's tax legislation with regard to payments from retirement funds was researched, by studying the *Income Tax Act*, as well as all the its amendments since 2001. The relevant sections (as identified in the background) and amendments thereto were interpreted to determine what the legislator currently views as the source of retirement fund payments for residents and non-residents for tax purposes.

After completing the above, the similar international practices as set out by the OECD and the UN were considered. Thereafter, similar sections in the tax legislation of other countries such as Australia, Canada, New Zealand and the United Kingdom were studied and interpreted to determine what their legislator currently views as the source of retirement funds payments for residents and non-residents.

A comparison was drawn between the tax treatments to determine how South Africa's tax treatment of cross-border retirement benefits compares to those of the other countries and international practice. In this study the technical aspects of tax legislation were interpreted (descriptive research) along with an international comparison (comparative research) and a conclusion was drawn.

1.5.2 Literature review

The purpose of a literature review is to gain an understanding of the existing research that is relevant to a specific study (Western Sydney University, 2017:1). Several resources were used to address the problem statement, such as the *Income Tax Act* and the tax legislation of other countries, such as Australia, Canada, New Zealand and the United Kingdom. The development of South Africa's tax treatment was studied through amendments made to the *Income Tax Act* since 2001. Other resources such as books, journal articles and internet articles were also used.

Australia, Canada, New Zealand and the United Kingdom are the countries that were used as comparison in this study. All four these countries have been member countries of the OECD for over four decades (OECD, 2020a) which means they have well-established taxation policies in place, which include policies with regard to the taxation of cross-border retirement benefits for residents and non-residents.

1.6 Chapter overview

Chapter 1: Introduction

This chapter is the starting point of the study which provided some background information to the study as well as the relevance thereof. A general overview on the current taxation of retirement benefits for residents and non-residents for tax purposes was provided. A problem statement was made, research objectives were formulated and an overview of the research design and method used was explained.

Chapter 2: Development of South African tax legislation with regard to retirement benefits

This chapter focusses on how South Africa's tax legislation developed since 2001 when the change from source based to residence based taxation was made, specifically relating to the taxation of retirement benefits. Any later amendments to applicable sections in the legislation and their explanatory memoranda is discussed.

Chapter 3: Analysis and comparison of the policies of Model Tax Conventions

The Model Tax Conventions for double tax agreements of the Organisation for Economic Co-operation and Development and the United Nations are discussed, with specific reference to the cross-border tax treatment of payments from retirement funds. The taxation policy as set out by the conventions are compared to the tax treatment of such payments by South Africa, as discussed in Chapter 2.

Chapter 4: Analysis and comparison between South Africa and other countries

In this chapter an analysis is performed to compare the tax treatment of cross-border retirement benefits by South Africa to the tax treatment of other countries, such as Australia, Canada, New Zealand and the United Kingdom. The tax treatment for the aforementioned countries are discussed first, after which a comparison is drawn to South Africa's tax treatment of payments from retirement funds.

Chapter 5: Summary and conclusion

This chapter provides a summary of the study and its research question as set out in Chapter 1. It also contains a discussion on the conclusions drawn from the research as well as a brief discussion on possible future areas of study.

CHAPTER 2 DEVELOPMENT OF SOUTH AFRICAN TAX LEGISLATION WITH REGARD TO RETIREMENT BENEFITS

2.1 Introduction

Retirement and tax are aspects that employees think about during their careers. Due to the fact that people are living longer, some people are less prepared for retirement than they were many years ago (Collinson & van Weede, 2012). Most people do not save enough for retirement and are also worried about the taxes they will owe when they receive their retirement benefits (Nelson, 2016). Since 2000, South Africans have seen many changes in the tax legislation, specifically in the tax treatment of the benefits from retirement funds with the most recent amendment to section 10(1)(*gC)* in 2016. A secondary objective of this study, as mentioned in Chapter 1, is to analyse the development of the South African tax legislation with regard to benefits from retirement funds with a cross-border component.

Income from retirement benefits are unique from other types of income since it has different cash flows which are taxed at different points in time (Stenlund, 2020). It is important for taxpayers to understand the position and tax consequences of South Africa's retirement fund system, since it is one of the major concerns upon retirement. Knowing which tax benefits are available to retired people is useful when making decisions about their future retirement plans (Baines, 2018).

This chapter centres on the way that South African tax legislation has developed since 2001 when it changed from source based to residence based taxation, with specific reference to benefits from retirement funds. This includes the study of relevant amendments to applicable sections in the legislation and their explanatory memoranda. The purpose of this chapter is to determine what South Africa's tax position is for residents and non-residents with regard to the source of payments from retirement funds with a cross-border component.

2.2 Overview of income tax in South Africa and the change from source based to residence based tax

Income tax was first introduced in South Africa in 1914, when General Jan Smuts, as Finance Minister of the Union of South Africa, introduced a general income tax with the *Income Tax Act* of 1914 (Ndlovu, 2017). The first income tax principles in South Africa were based on the principles that tax would be levied only on income sourced in South Africa.

Since the introduction of income tax, the South African government has been appointing commissions and committees with the purpose to investigate issues relating to tax and to make recommendations (Steyn & Stiglingh, 2016). In 1994, the Katz committee was established with the broad mandate to investigate basically every aspect of the South African tax regime against the political, social and economic goals of the new post-apartheid government (Manuel, 2002).

In a speech at the Annual Conference of the International Bar Association on Thursday, 24 October 2002, a former Minister of Finance, Trevor Manuel, stated that the government has been committed to broadening the tax base in order to lower overall rates and that this was done through major tax reforms (Manuel, 2002). One of these major tax reforms was taxing residents on a worldwide basis and not only on source basis of income. In 1997, the Katz committee published a detailed report i.e. basing the South African Income Tax System on the Source or Residence Principle – Options and Recommendations, which addressed what the tax base of the South African tax system should be.

Under the residence system, a resident's worldwide income will be subject to the taxes of the country of residence (Katz Commission Report, 1997). The case of *Kergeulen Sealing and Whaling Co Ltd v Commissioner of Inland Revenue* (1939) looked into the rationale of this and it was held that:

> In some countries, residence (or domicile) is made the test of liability for the reason, presumably, that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters him. (p. 508)

Under the source system, income is taxed in the country where the income originates, regardless the residence of the person (Katz Commission Report, 1997). The rationale of this was also addressed in the case of *Kergeulen Sealing and Whaling Co Ltd v Commissioner of Inland Revenue* (1939). It was held that:

> In others (as in ours) the principle of liability adopted is "source of income" again presumably the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live. In both systems there is, of course, the assumption that the country adopting the one or the other has effective means to enforce the levy. (p. 508)

It is clear from the above that there existed a rationale for both tax regimes. However, in its report, the Katz committee stated there would be many factors to take into account when choosing which system is appropriate for a country like South Africa. Such factors include economic strategies, net cross-border capital flows, and the relative size of the economy, tax treaties, history and administrative capacity (Katz Commission Report, 1997).

Subsequently, a former Minister of Finance, Trevor Manuel, announced one of the biggest tax changes in South Africa. On 23 February 2000, he announced during his budget speech that for tax years commencing after 1 January 2001, the tax system of South Africa will move from a source principle to a residence-based income tax for South African tax residents (Manuel, 2000). According to Padayachee *et al*. (2001:1357), the 2000-2001 budget was regarded as a result of the process of reformation of tax in South Africa that began in the 1990's. Trevor Manuel also said in his speech that the tax proposals "constitute the most extensive set of tax reforms ever undertaken in this country".

Consequently, the gross income definition in section 1 of the *Income Tax Act* was amended and reads as follows (*Revenue Laws Amendment Act*, 2000, later again amended by the *Taxation Laws Amendment Act*, 2012):

> '**gross income'**, in relation to any year or period of assessment, means—
>
> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
>
> (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment,
>
> excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder;

The amendment meant that worldwide income would be included in the gross income of a resident, but any person other than a resident, will only be taxed on South African source income. According to the National Treasury (2000), the income tax base of residents was extended to include all income. A section *6quat* credit would however be allowed against the South African tax liability if foreign taxes were paid on the income in order to avoid the burden of double taxation on the same income of a person. These changes have also affected the way that South Africa taxes benefits from retirement funds. The remainder of this chapter focuses on the changes to benefits received from retirement funds upon retirement and what the source of such payments are when there is a cross-border component involved.

2.3 The need for a separate set of tax rules for retirement funds

The National Treasury estimates that about only six percent of South Africans are able to retire comfortably, due to the low national savings rate and the slow market growth (Franklin, 2019).

However, according to Louw (2015) the government can put measures into place to encourage individuals to save more towards their retirement. South Africa does this by providing tax relief to individuals who contribute to retirement funds, through deductions from their taxable income.

Retirement funds can include a pension fund, provident fund, retirement annuity fund and preservation funds. A pension fund is defined in the *Pension Funds Act 24 of 1956* as an association of persons engaged in any occupation with the object to provide benefits for its members upon retirement. A pension fund is a form of forced savings, where an employee saves some of his income for the future (Boulier, 2001). A provident fund is similar to a pension fund in the sense that it is set up to provide an employee with some benefits upon retirement (Godden, 2010:24). The *Income Tax Act* defines a provident fund as a fund which the Commissioner approved and which is registered under the *Pension Funds Act 24 of 1956*.

A retirement annuity fund differs from the above in the sense that it is not linked to a person's employer (Godden, 2010:24). It allows the employee to choose which funds to invest in and the change of employer will not have an impact on the contributions and benefits received from the fund (Smith, 2020).

The taxation of retirement benefits in South Africa is different from the tax on normal income due to the fact that the payment of tax on retirement benefits is delayed to a future date when the benefits will accrue to the member (Van Rensburg, 2014). The South African Government wants to encourage employees to keep their savings until they retire and then convert that savings into income upon retirement (Department of Education, 2014). Accordingly, South Africa provides tax deductions on the contributions to retirement funds as set out in section 11F of the *Income Tax Act*. The employee will be taxed upon retirement and will receive a once-off exemption of R500 000 upon receiving the retirement benefit (SARS, 2020d). This exemption is only R25 000 when the benefits are withdrawn before retirement in order to motivate employees to receive the benefits at retirement and not withdraw it beforehand (Stiglingh *et al.*, 2020). The tax treatment of the other abovementioned type of retirement funds are mostly similar (SARS, 2020d) and in the discussion to follow, retirement funds are referred to as the collective term for all these funds.

The National Treasury's explanatory memorandum to the Taxation Laws Amendment Bill (2007) provided the rationale for the simplified tax treatment of benefits received from retirement funds. It stated that all retirees will be eligible for a life-time tax exempt amount and the remainder of the retirement benefit will be taxable as gross income since the person obtained a deduction during their lifetime in terms of section 11(*k*) (later amended to section 11F). Where a deduction was previously disallowed, retirees will receive an additional tax-free lump sum treatment (Stiglingh *et al.*, 2020).

When a person retires as a member of a retirement fund, that person is allowed to take one-third of the retirement interest as a lump sum and the remainder will be received in the form of an annuity, if the whole benefit exceeds R247 500 (SARS, 2020d). This rule exists in order to protect the existing and future benefits for the person who is retiring and to make the tax system equitable (The South African Labour Guide, 2015). However, when a person retires as a member of a provident or provident preservation fund, the retiree can take the whole amount as a lump sum (SARS, 2020d). Government, however, seeks to align provident funds to work in the same way as pension and retirement funds from 2021, in order to ascertain simplicity in the tax treatment of retirement benefits (Smith, 2020). Due to retirement funds being taxed differently than normal tax in order to encourage people to save for their retirement, taxation rules were developed for retirement benefits which is discussed in more detail in the following section.

2.4 The development of taxation of retirement benefits for tax residents

2.4.1 General principles

Any receipt from retirement funds (both annuities and lump sums) will be included in the gross income of a resident (Van Rensburg, 2014). These receipts are not of a capital nature in accordance with South Africa's capital gains tax rules. Paragraph 54 of the Eighth Schedule to the *Income Tax Act* states that a person must disregard any capital gain or loss in respect of a disposal that resulted in a person receiving a lump sum benefit paid from a fund.

In terms of paragraph (*a*) of the gross income definition in section 1 of the *Income Tax Act*, any amount received or accrued by way of annuity will be included in the gross income of the person. Therefore the annuity payments that the person receives from the fund after retirement, usually monthly, will be included in the gross income of the person receiving the payments.

Paragraph (*e*) of the same gross income definition, which has been amended several times, includes in a person's gross income the retirement fund lump sum benefit or retirement fund lump sum withdrawal benefit, other than any amount included under paragraph (*eA*). Paragraph (*eA*) refers to payments received by members who remain in the employment of their employer or dependents of a deceased member, which is outside the scope of this study. It is clear that any lump sum benefit or lump sum withdrawal benefit received by a person from a retirement fund will be included in the gross income of said person.

The lump sum payments will however be taxed under the retirement fund lump sum benefit table as opposed to the normal individual tax table (SARS, 2020d) in order to allow for the R500 000 once-off exemption given to retirees as motivation. The Second Schedule to the *Income Tax Act* specifically deals with the determination of the lump sum benefits paid by retirement funds

(Stiglingh *et al.,* 2020). The rules of the Second Schedule should always be read in conjunction with the rest of the *Income Tax Act* sections that relate to retirement.

2.4.2 The impacts of the tax base change since 2001

When the South African tax base principles changed in 2001, receipts from foreign funds would, starting from 2001, also be included in the gross income of the resident. All of the abovementioned gross income provisions will still apply. Section 10 of the *Income Tax Act*, which deals with exempted income, was however amended by section 13(1)(*d*) of the *Revenue Laws Amendment Act* of 2000, by inserting section 10(1)(*gC*) that reads as follows:

(*gC*) any–

> (i) amount received by or accrued to any resident under the social security system of any other country; or
>
> (ii) pension received by or accrued to any resident from a source outside the Republic, which is not deemed to be from a source in the Republic, in consideration of past employment outside the Republic;

This *Amendment Act* included worldwide income of a South African tax resident in its gross income, but this section provided some relief for retirement fund payments received from a source outside South Africa that relates to past employment outside South Africa. This policy makes sense, since a resident will not receive deductions for contributions made to a foreign fund as the fund was not created by South African law, and the receipts from that fund should be exempt, subject to any double tax agreement (Van Zyl, 2015).

According to the National Treasury, the taxation of foreign pensions has raised some controversy. At that stage foreign pensions were exempt from income tax, but it was international practice for a person's country of residence to tax foreign pensions. The National Treasury however argued that foreign pensions should not be taxable once South Africa moves to a worldwide tax base, since it will prevent retirees from retiring in South Africa (National Treasury, 2000). However, in most examples of other countries, the country of source will tax the pension if the country of residence does not tax the pension. It was therefore proposed that foreign pensions would not be taxed at that point in time, but it was simply an interim measure and the issue would have been revised.

2.4.3 Amendments to clarify the source of payment

One year later, in 2001, section 10(1)(*gC*) was amended by adding a reference to section 9(1)(*g*) of the *Income Tax Act* in order to determine whether the retirement benefit is from a source outside the Republic (section 9(*a*) of the *Revenue Laws Amendment Act* (2001)). At that stage, section

9(1)(*g*) stated when a retirement benefit is derived from a South African source, an amount received by reason of pension or annuity will be deemed to be from a source within the Republic if it was granted to the person for services rendered in South Africa. The location of the fund which made the payment, is not the only deciding factor to determine the source.

The deciding factor is that the person should have performed the services within the Republic for at least two years during the ten years immediately preceding the date from which the pension or annuity first became due. If services were rendered partially within and partially outside the Republic, only the portion of the pension or annuity that equals the ratio of the total period of which services were rendered in South Africa, to the total period of services rendered overall, would have been deemed to be derived from a source within the Republic (section 9(1)(*g*)). The above addition to section 10(1)(*gC)* referring to section 9(1)(*g*), meant that payments from retirement funds were not deemed to be from a South African source, if the related services were rendered outside South Africa, in addition to the payment being made from a fund in South Africa. The abovementioned two year rule was replaced with the amended section 9 in 2011.

2.4.4 The impacts of amendments to section 9

Section 10(1)(*gC*)(ii) was subsequently amended to exclude the above reference to section 9(1)(*g*), since the whole section 9 was substituted by a new section in 2011. According to the National Treasury (2011), the source rules gave rise to uncertainty and subsequently certain deemed rules, in addition to common law rules, of what constitutes South African source income were instituted. Another motivation for including the deemed rules into legislation was that changes took place after South Africa moved from a sourced based to a residence based tax system and the source rules needed revision. The starting point for the source rules was based on double tax agreement principles in order to have the South Africa tax system globally aligned (National Treasury, 2011).

Section 9 of the *Income Tax Act* was replaced with a new section that determined when income is deemed to be from a South African source (section 22(1) of the *Taxation Laws Amendment Act*, 2011), since this term is not defined in the *Income Tax Act*. The new section 9(2)(*i*), which can be applied to both residents and non-residents, specifically relates to pensions and annuities and reads as follows:

> (2) An amount is received by or accrues to a person from a source within the Republic if that amount—
>
> (*i*) constitutes a pension or an annuity and the services in respect of which that amount is so received or accrues were rendered within the Republic: Provided that if the amount is received or

> accrues in respect of services which were rendered partly within and partly outside the Republic, only so much of that amount as bears to the total of that amount the same ratio as the period during which the services were rendered in the Republic bears to the total period during which the services were rendered must be regarded as having been received by or accrued to the person from a source within the Republic;

The common law source rules gave rise to uncertainty and imposed additional costs in respect of cross-border activities with little benefit to the South African fiscus (Van der Walt, 2011). The 2011 amendment of section 9 cleared uncertainties and ensured that South Africa's tax system was aligned with the rest of the world (Stiglingh *et al.,* 2020). The amended section 9 contained deemed source rules with incorporation of common law, pre-existing statutory law and double tax agreement principles (Van der Walt, 2011).

According to the National Treasury (2011), the source for annuity and pension payments is based on the source of the underlying service that gave rise to the payments. If the employee rendered services in South Africa, the associated annuities and pensions are viewed as South African sourced. If the person rendered services both inside and outside South Africa, the income from annuities and pensions will be taxable in the related countries based on time spent on the services in each country. The National Treasury further stated that uncertainties were to be cleared with the uniformed system as proposed by section 9 and that the rules for pension funds and annuities are in essence the same as pre-existing law, but were now laid out in the *Income Tax Act* (National Treasury, 2011).

In 2014, section 9(2)(*i*) was amended to include the word "lump sum" and not just a pension or annuity in order to widen the scope of the section (*Taxation Laws Amendment Act*, 2014). The same amendment made to section 9 in 2014 was also made to section 10(1)(*gC)* in 2014 where lump sums and annuities were included in the section and not just pensions in order to widen the scope (section 14(1)(*c*) of the *Taxation Laws Amendment Act*, 2014.

This section was also amended in 2016 to widen the scope even further and include a lump sum, pension or annuity by a pension fund, pension preservation fund, provident fund or provident preservation fund, which also widened the scope of funds from which the retirement benefit can be received (*Taxation Laws Amendment Act*, 2016).

The amendment in 2016 however excluded retirement annuity funds. According to the National Treasury (2016), the reason for this was that contributions to retirement annuity funds are not linked to employment and should not be associated with services rendered inside or outside South Africa. It therefore makes sense that funds received from retirement annuity funds should not fall within this set of rules.

The current legislation is silent on the specific source rules for a retirement annuity fund and a taxpayer should apply common law principles to determine the source of the benefits from a retirement annuity fund. The South African Institute of Chartered Accountant states that if section 9 does not apply, the common law principles for the source of income from services rendered is regarded to be the location where the services were rendered (SAICA, 2015).

2.4.5 Amendment to section 10(1)(*gC)* in 2016

Firstly, section 10(1)(*gC)* aligns with section 10(1)(*o)*(ii), which exempts employment income of residents for services rendered outside South Africa from tax. This exemption applies if the person is outside South Africa for more than 183 days, of which 60 days must be consecutive. From 2 March 2020, this exemption will only apply to the first R1 million earned (SARS, 2020b). The National treasury introduced these sections to prevent double taxation since South Africa taxes residents on worldwide income but provides some relief to residents on double taxation.

In 2016, a change that was called a “major change” by the South African Institute of Tax Professionals, was made to section 10(1)(*gC),* where it excluded benefits from a South African fund to be exempt from tax (Gouws, 2017). This amendment applied to retirement benefits received by a resident as consideration for past employment outside South Africa from a pension fund, pension preservation fund, provident fund, provident preservation fund and retirement annuity fund which is defined as South African funds in section 1(1) of the *Income Tax Act* (section 23(1)(*b*) of the *Taxation Laws Amendment Act*, 2016). This means that the exemption from income tax will not apply to payments received from local funds, irrespective of where the employee renders the services (Stiglingh *et al.*, 2020). As a result, it meant that if the payment is made from a South African fund for employment rendered outside South Africa, the exemption will not apply and the person will be taxed on the receipt of the retirement benefits. This amendment affected South African tax residents who have spent a portion of their working life rendering services abroad, while continuing to remain members of their South African retirement fund (Gouws, 2017).

According to the National Treasury (2016), there was uncertainty regarding the interpretation of section 10(1)(*gC),* which required amendment. The motivation that gave rise to the amendment, was that tax residents of South Africa who worked outside the country, can receive a tax deduction on contributions they make to local retirement funds (Jadezweni, 2016). However, upon receipt of the retirement benefits, the amount that accrued while the residents were working outside the country would have been tax free (National Treasury, 2016). This did not seem fair to South Africa’s tax base according to the National Treasury, and therefore they proposed this amendment to ensure fair tax treatment. Subsequent to the amendment, which became effective on 1 March

2017, the exemption in section 10(1)(*gC*) only applies to retirement benefits from foreign funds or amounts relating to foreign funds that were transferred to local funds (Jadezweni, 2016).

Any amounts transferred to South African funds from a source outside the Republic will still receive the exemption (section 10(1)(*gC).* Some confusion existed as to how narrow taxpayers should interpret this clause. The narrow interpretation will mean that funds can only be transferred from a foreign pension fund to a South African retirement fund while the wider interpretation can imply that any amount can be transferred to a South African retirement fund (De Villiers, 2017). However, it seems that the South African Revenue Service (hereafter the SARS) follows the narrow approach. This means that funds transferred from a foreign pension fund will still be exempt, which is in line with the policy change made by the National Treasury, which is that benefits from foreign funds should be exempt from tax.

With the amendments in 2016, which came into effect in 2017, the application of the exemption of foreign pensions for South African tax residents have been narrowed (Jadezweni, 2016). Gouws (2017) called this a nasty surprise for taxpayers, since retired South African residents who have previously worked abroad as well as those on their way to retirement, will face an increased tax burden in respect of payments originating from South African funds. The change did not only affect future retirees, but also those who have already retired. Some retirees have also worked for years under a specific dispensation to build up sufficient savings for retirement and retrospective change will have a material effect on their retirement (Pretorius, 2018).

Since section 10(1)(*gC*)(ii) only exempts foreign service retirement benefits received from foreign retirement funds or foreign service amounts which were transferred from a foreign retirement fund to a local retirement fund, it seems that for South African tax residents, the net effect of the cross-border retirement benefits is that only South African sources income is taxed.

The Davis Tax Committee have reminded resident taxpayers that if any arrangement, such as accumulating funds in a foreign fund in order to make use of the abovementioned exemption, is made in order to conceal its true purpose, the SARS has the anti-avoidance powers to address such cases (Davis Tax Committee, 2016). There is however no reason why an individual cannot make use of a foreign retirement fund, provided the taxpayer uses it for the purpose of providing for retirement and no other hidden purpose.

2.4.6 Issuance of the SARS ruling

In 2014, the SARS issued Issue 1 of Binding General Ruling No. 25 in order to clarify their interpretation of the income tax exemption which applies to pension benefits from a foreign source (Bowmans, 2014). Its purpose was to provide clarity on the exemption “from a source outside the

Republic as consideration for past employment outside South Africa". When section 10(1)(*gC*) was amended in 2016, the Binding General Ruling had to be adjusted and, subsequently, Issue 2 of the Binding General Ruling No. 25 was issued in 2017 and replaced Issue 1. The purpose of this second issue was to provide clarity on the interpretation and application of the words "from a source outside the Republic" in section 10(1)(*gC*) that relates to pension payments received by or that accrued to a resident.

The second issue of the ruling stated that the term "source outside the Republic" can be interpreted as the originating cause which gave rise to the pension, which is the foreign services rendered, or it can mean the location from which the pension is received, i.e. where the fund is situated (SARS, 2017). To resolve ambiguity, the ruling stated that, for purposes of section 10(1)(*gC*), the term should mean the originating cause which gave rise to the pension income, which is where the services have been rendered. The location of the fund is consequently not relevant in terms of the ruling.

However, according to the amendment to section 10(1)(*gC*), it is clear that should the payments be made from a local fund, the exemption will not apply, which means that payment have to be received from an overseas fund in order for the receipt to be excluded from normal tax. Consequently, it seems that for residents for tax purposes in South Africa, the amount is taxed on the basis of where the fund is located, which is the source of the payment, even though it seems as if the Binding General Ruling No. 25 tries to state that the location of where the services were rendered will be the source. Binding General Ruling No. 25 however only applied until 4 October 2018 and has since been archived (SARS, 2020d). The SARS has not issued further guidance since.

The conclusion made from the above legislation, explanatory memoranda, rulings and interpretations from the SARS, is that if the employee rendered services outside South Africa and received a pension or annuity from a foreign retirement fund for that services, it will be exempted from tax in South Africa. If a South African retirement fund made the payment, it will not be exempted from tax, irrespective of where the service was rendered.

2.4.7 Tax treatment for residents

In conclusion, tax residents of South Africa must include receipts of both local and overseas funds in their gross income. Receipts from overseas funds for work performed abroad will however be exempted from normal tax, but only if the fund is also located outside South Africa. In conclusion, the net effect for residents are that they are taxed on retirement benefits from a South African source.

2.5 The development of taxation of retirement benefits for non-residents

Non-residents of South Africa may be required by their employer, or may voluntarily, perform services in South Africa for a period of time. It can also happen that South African employers want to make use of foreigners' skills and knowledge and will employ them for a specific period of time (SchoemanLaw Inc., 2019). During this time, they may be required to contribute to a South African registered retirement fund and leave their retirement benefits in South Africa for future growth upon retirement.

2.5.1 General principles

South Africa taxes non-residents on their South African source income (*Income Tax Act*, 1958). Prior to 2011, the *Income Tax Act* did not define the term source and taxpayers had to refer to common law to gain clarity on this issue. In the case of the *Commissioner of Inland Revenue v Lever Brothers & Unilever Ltd* (1946), it was evident that the source of receipts is not the area from which the receipt comes, but rather the originating cause of it being received as income and this originating cause is the work which the taxpayer does to earn the income (*Commissioner of Inland Revenue v Lever Brothers & Unilever Ltd*, 1946). If the originating cause of the income and what the location of said originating cause was, is established, that would in turn determine the source of the income.

2.5.2 The impacts of amendments to section 9

As discussed above and according to the explanatory memorandum on the *Taxation Laws Amendment Act* (2011), the above common law conditions gave rise to uncertainty and subsequently certain deemed source rules were instituted. Since non-residents are taxed on South African source income (section 1 of *Income Tax Act*), greater certainty was needed for when income will be from a South African source (Van der Walt, 2011). Another motivation for including the deemed rules into legislation is that changes took place after South Africa moved from a sourced based to a residence based tax system and the source rules needed revision. The starting point for the source rules was based on double tax agreement principles in order to have the tax system globally aligned (National Treasury, 2011). As a result, non-residents, who are subject to double tax agreements between their country and South Africa, will have more certainty as to when income is received from a source in South Africa (Pickering, 2013).

Section 9(2)(*i*), as already discussed above, deems benefits from a retirement fund to be from a source in South Africa if the services were rendered in South Africa. This means that if a person receives benefits from a retirement fund and the services to which that receipt relates were rendered in South Africa, that receipt will be deemed to be from a South African source. If the employee rendered services both inside and outside South Africa, the retirement benefits will be allocated for tax purposes to the related countries based on time spent on the services in each country (National Treasury, 2011).

Since South Africa taxes non-residents only on South African sourced income, payments for services rendered outside the Republic will not be taxable in South Africa, since it is neither from a source in South Africa, nor is the person a resident of South Africa and it falls outside the tax net of South Africa. Therefore, it is clear that for non-residents, South Africa will tax the amount if the person rendered the services in South Africa, as well as if the fund is located in South Africa. There are no exemptions in section 10 for non-residents who receive retirement benefits that relate to services rendered in South Africa. The taxation of a non-resident is furthermore dependent on the taxation rules of the non-resident's country of residence together with any possible double tax agreement between South Africa and the person's country of residence (SARS, 2020c). In conclusion, the deciding factor on the source of retirement benefits for a non-resident, is where the services are rendered and not only where the fund is located.

2.6 Conclusion

The South African tax system for benefits received from retirement funds has evolved since 2001 for both residents and non-residents due to many taxation changes taking place in South African legislation. South Africa taxes residents on worldwide income and also on worldwide retirement benefits. Residents will however not be taxed if the retirement benefits were paid from a foreign fund for past services rendered abroad. The sections dealing with these benefits, especially section 10(1)(*gC*), have seen many changes since 2001. A study of these developments resulted in the conclusion that for tax residents of South Africa, the residence-based tax principles are not followed.

However, South Africa taxes non-residents on South African sourced income. For non-residents the deciding factor on the source of the payments from the retirement fund is based on the location where the services were rendered and not only the location of the fund which made the payment. The chapters to come compares the abovementioned treatment to Model Tax Conventions and the tax legislation of other comparable countries.

CHAPTER 3 ANALYSIS AND COMPARISON OF THE POLICIES OF MODEL TAX CONVENTIONS FOR CROSS-BORDER RETIREMENT BENEFITS

3.1 Introduction

Multinational companies can expect their employees to work outside their country of residence for a period of time or employees want to work abroad for experience (Sunjka, 2020). Employees working in another country might wish to still contribute to a retirement fund in their country of residence since switching funds can lead to a loss of benefits and also because of the practical difficulties in switching funds. Allowing this continued contribution will ensure that people are not discouraged from taking up work overseas (OECD, 2017a:352-353). These employees can however encounter difficulties in relation to cross-border taxation of the retirement fund they have established in their home countries upon retirement (The European Commission, 2014).

For the tax treatment of retirement fund benefits to work properly in cross-border situations, the involved countries should have similar tax treatment of the pension which is not the case in reality (Isakova, 2019). This can lead to double taxation, double non-taxation and other undesired tax consequences (OECD, 2003).

The Organisation for Economic Co-operation and Development (hereafter the OECD) is an international organisation with the goal to outline policies that raise prosperity, equality, opportunity and well-being for all (OECD, 2020c). The OECD shares the best practices and advice on public policies, which include tax policies. Member countries value the OECD as an educator, while governments look to the OECD for advice on economic growth and structural reform, which means that the OECD is a specialist in its field (MacLeod, 2016). Countries see the OECD as a reliable source of data and also regard the OECD policies as a platform for benchmarking. Cockfield (2006) also describes the OECD as an informal world tax organisation due to their responses to tax challenges, such as publishing a Model Tax Convention on which many double tax agreements are based.

South Africa is not currently a member country of the OECD. South Africa and the OECD do however share a mutually beneficial relationship, where South African policy makers gain access to OECD expertise and good policy practices, while the OECD benefits from exposure to South African policy perspectives to enhance mutual learning (OECD, 2020b). The National Treasury makes many references to the OECD principles in its publications as a result of this relationship.

In 2019, the OECD, the SARS and the National Treasury signed a Memorandum of Co-operation agreeing to work together in the area of taxation.

The UN, on the other hand, is an international organisation that can take action on issues confronting humanity (United Nations, 2020a). South Africa is a member country of the UN. The UN also published a Model Double Tax Convention with the aim to provide guidance to countries in designing double tax agreements (United Nations, 2011).

South Africa base their double tax agreements on the OECD Model Tax Convention (Steenkamp, 2016). In this chapter, more focus will be placed on the OECD Model Tax Convention (hereafter the OECD model). References to the United Nations Model Double Tax Convention (hereafter the UN model) will however also be made in order to establish the international policy on the source of cross-border retirement benefits.

This chapter concentrates on what the Model Tax Conventions' position is regarding the cross-border tax treatment for benefits received from retirement funds. The OECD and the UN position on what the source of benefits from retirement funds are, is compared to that of South Africa, which addresses a secondary objective of this study. In Chapter 2, it was determined that South Africa has different deciding factors on the source of retirement benefits for residents and non-residents. Comparing it to the policy of the Model Tax Conventions will further address the objective to determine how South Africa's tax treatment, as established in Chapter 2, compares to international standards.

3.2 The importance of allocating taxing rights of retirement benefits

The taxation of cross-border pensions is diverse and inconsistent between countries (Genser & Holzmann, 2018). Rising life expectancy and the international mobility of people will only add to the complexity of such retirement regulations. As already mentioned, when countries have the same tax rules in relation to retirement benefits, there are less issues in terms of double taxation or double non-taxation, since the tax authorities of the different countries will tax the retiree in the same way. However, when there are discrepancies regarding taxation of retirement benefits, problems can arise. For instance one country can tax the retirement benefits when it is paid out to the retiree, while another country taxes the retirement benefit during the contribution and wealth accumulation phase, the latter resulting in a person making contributions to the retirement fund from income after tax. Individuals who change their residency before retirement, can then have the problem of double taxation or double non-taxation (Genser & Holzmann, 2018).

The OECD identified the need for clarity on this issue since the globalisation of the economy and the increased international communication that has led to an increase of people who work in more than one country, resulting in different pension arrangements (OECD, 2017:344a). If the treatment of benefits from retirement funds differ between countries, issues can arise that result in mismatches between the different taxation policies of different countries. There is a need for the Model Tax Convention to address these cross-border mismatches to avoid double taxation or non-taxation (OECD, 2017b:C(18)-4).

The OECD model is a publication issued by the OECD with recommendations on double tax agreements. Its purpose is to clarify, standardise and confirm the fiscal situation of taxpayers who engage in activities in other countries in the case of double taxation (OECD, 2017a). Double taxation can occur when a person has international economic interests and as a result may become subject to tax in both the international country and the country of residence. Countries enter into double tax agreements in order to eliminate double taxation of the same income by two countries (SARS, 2020a).

The OECD model is a model for countries who entered into double tax agreements, and more than 3 000 double tax agreements are based on the OECD model (Owens & Bennet, 2008), including agreements with a non-OECD member country as a party to the agreement, such as South Africa (Olivier & Honiball, 2011:271). Many principles in South African double tax agreements are found in the OECD model (Steenkamp, 2016). The OECD also publishes extensive commentary on the articles of the model which carry significant weight in the interpretation of double tax agreements (Lang & Brugger, 2008).

It is therefore necessary to analyse what the OECD’s view is on allocating taxing rights to retirement fund benefits in order to determine whether the South African tax treatment is in line with international practices. For the purpose of this chapter, the 2017 edition of the OECD model, and the commentary thereto, will be used since it is the latest updated version.

3.3 The Model’s policy on the allocation of taxing rights of retirement funds

The OECD model deals with pensions in Article 18. It includes payments made to former employees and other similar payments such as annuities and lump sum payments (OECD, 2017a:343-344). These payments are made in consideration of past employment and is therefore distinguished from other income. Article 18 is therefore the applicable section of the model to consider in this study as it relates to retirement benefits.

3.3.1 Country of residence has taxing rights over retirement benefits

Article 18 of the OECD model states that pensions and other similar remuneration, paid to a resident of a contracting state, as consideration for past employment will be taxable only in that state (OECD, 2017a:39). Therefore the country of residence has the exclusive right to tax benefits from retirement funds. The reasoning behind this is that the country of residence is in a better position to take into account the person's overall ability to pay tax and to avoid an administrative burden being placed on the person to comply with international tax obligations (OECD, 2017a:343).

The country of residence will be the country in which the retiree is a resident for tax purposes in terms of the domestic tax law of the country. A person can be deemed a tax resident of more than one country in terms of each country's domestic rules. In such cases, the double tax agreement will determine which country is the country of residence (Louw, 2020).

3.3.1.1 Reasons that the country of residence is appropriate

A majority of countries follow the OECD approach to allow the residence country to have the exclusive taxing rights of retirement benefits (Stenlund, 2020). If the country of residence has the exclusive right to impose tax on the retirement fund payments, the retiree will only need to comply with the tax rules of their country of residence and not the rules of more than one country (OECD, 2017b:C(18)-7). A retiree will then not have the administrative burden of understanding the other country's tax rules and systems, registering for tax in another country or filing tax returns in that country (The European Commission, 2014).

This means that the country of residence taxes the retirement fund benefits, even if it accrued in an overseas country, in order to prevent resident taxpayers from using foreign retirement funds to avoid tax on their income (United Nations, 2019). This may however lead to the risk that a retiree will not report his foreign retirement fund income, but it can be reduced by exchange of information and adequate taxpayer compliance systems (OECD, 2017b:C(18)-8).

However, if only the country of residence has taxing rights over the retirement fund benefits, it may lead to retirees changing their tax residency to a country that does not impose tax on retirement benefits upon retirement (Stenlund, 2020). A person can misuse the different tax rules for their own benefit. The principle of neutrality, which implies that a tax system should not affect the behaviour of an individual, will be compromised in such a case (Berglund & Cejie, 2018).

3.3.2 Taxing rights of retirement benefits, other than the country of residence

Different countries have different rules relating to the taxation of retirement benefits and there are countries which are hesitant to use the principle that only the country of residence can tax pensions (OECD, 2017a:343). Individuals can misuse those provisions in order not to pay any tax at all on retirement benefits. For example, a person can be a resident of a country which allows them to deduct contributions made to retirement funds and then before retirement change their residency to a country that does not tax retirement fund benefits upon its receipt (OECD, 2017a:346). According to the European Commission (2014), a trend is seen where newer double tax agreements include more detailed provisions with regard to the treatment of retirement fund benefits, instead of keeping the template provision.

The exclusive right of the country of residence to tax the retirement benefits can result in the source country losing tax revenue through the transfer of fiscal capital to another country (Stenlund, 2020). Through globalisation of the economy and increased prevention of tax avoidance, there may be reason to consider another type of allocation of taxing rights for retirement benefits. Countries should consider shared taxation rights for retirement benefits. The UN model (2011) also makes an alternative provision for shared taxation rights between the country of residence and the country of source (Lennard, 2008).

Sharing taxing rights is when the right to tax income is allocated between the residence and source country, with the benefit of preventing double non-taxation (Bosch, 2014). It allows the source country to retain the right to tax pension income that a person earned through work performed in that country. According to the United Nations (2011), pensions are, in essence, a form of deferred compensation for services performed in a specific country and that the source country should also have the rights to tax the pension. Countries are becoming more motivated to ensure that the taxing right of the source country remains intact since people became more mobile to move between countries. The retiree will however be required to know the tax rules of the countries in question (Starink, 2016), which may result in administrative difficulties, especially when more than two countries are involved.

Some authors argue that the source country should in principle have the right to tax the retirement income, since the person exercised employment in the source country (Starink, 2016). If the source country does not impose any tax, there is also a risk of double non-taxation if the country of residence does not impose tax on the income. The retiree will neither be liable for tax in the source nor in the residence country. A situation of double taxation can however also exist when the source country taxes the income before the residency is changed, and upon the change of residency, the new country of residency also taxes the income (Stenlund, 2020), which can lead to the retiree paying tax in both the source and residence country.

Furthermore, some countries do not fully tax pensions and exempt certain parts of pension payments. An example of this in South African tax legislation is the once-off exemption on lump sums from retirement funds, which is currently R500 000 (SARS, 2020d). When another country taxes an individual’s pension, it may result in an instance where that country taxes a pension which was not designed to be taxed (OECD, 2017a:348). This might seem unjustified and penalises retirees who worked abroad (United Nations, 2019). Countries can consequently decide to add a provision in their double tax agreements to ensure that the pension will still be exempt, even if the country of residence changed (OECD, 2017b:C(18)-8). This can provide grounds for considering adding a provision which states what the true source of retirement benefits are.

3.3.3 Conclusion on the views of the OECD and the UN

The OECD's main view is that the country of residence should tax the person's retirement benefits (OECD, 2017a:39), since it will simplify the administrative burden on the taxpayer. The UN shares this view, but on the other hand also makes provision for an alternative where the country of source can be allocated the taxing right of the retirement benefit (United Nations, 2017). Several countries also consider that retirement benefits paid in consideration of past employment should not be exclusively taxed in the residence country.

The OECD is cognisant of the fact that only giving the residence country taxing rights may not be the appropriate solution for all countries and they recognise the possibility for allocating taxing rights to the country where the retirement benefits arise. Its main principle is however to provide the country of residence with the taxing rights. According to Wisse (2012), the main difference between the Model Tax Conventions of the OECD and the UN, is the fact that the UN model provides for a larger allocation of taxing rights to the source country. The reason for that is that the UN model provides more guidance to developing countries who can then earn a larger portion of tax for its national budget if it is the source country. This is evident in the above analysis, where it can be seen that the UN model provides taxing rights to the country from which the pension arises, which is also something that the OECD recognises, but does not prefer.

3.4 The true source of "country from which the pension arises"

When a double tax agreement grants a source country the right of taxation, it means that the source from which the income is derived, is located in that country (Harris, 2013). The source country refers to the country in which income is earned or from which payment is made (Arnold, 2013). The country from which the retirement benefit arises can either mean that the pension fund who pays the benefit is established in that country or that the pension is derived from work performed in that country (OECD, 2017a:348). The source of income must be determined by using general principles.

A person receives benefits from retirement funds when they retire or resign. The person would have made contributions as a member to a retirement fund throughout their working life using income from employment (O'Connell, 2018). Consideration should be given to whether benefits from retirement funds are seen as investment income or as income from employment.

Normal investments are not linked to employment since the individual decides by themselves where and how much to invest. Career changes or interruptions will not have an effect on the investment, since the person makes the contributions themselves from which they earn interest and/or dividends (Duffy & Bafana, 2019). According to the OECD model (2017a), the taxing rights for investment income, such as dividends and interest, are allocated to the source and residence country, giving both countries the taxing rights. The source country is the country where the investment model is situated, such as a fund, company, financial institution or other investment vehicle (OECD, 2017a). The source country can charge tax up to a limited percentage, after which the residence country may tax the income. The residence country should give its resident taxpayer tax relief for the taxes paid to the source country's government. With a normal investment a person can choose the investments themselves and the returns are available immediately and not upon cessation of employment.

On the other hand, benefits from retirement funds differ from normal investment income in the sense that it is linked to employment and mostly arranged by a person's employer or an external pension provider (Dunn, 2020). Usually with a retirement fund, tax is withheld when payments are made to an individual (SARS, 2020d), which shows that the benefits from retirement funds are more closely linked to past employment than to a normal investment. Retirement income depends on the employment, earnings history and duration of working life (OECD, 2015). Incomplete careers have an effect on the retirement benefit, revealing the link between income from retirement funds and the past employment to earn that benefit. Since it is not just a normal investment, the source of the retirement benefits will be the country from which the pension arises, which can either be the country where the fund is established or the country where the person rendered the service.

3.4.1 Country where the retirement fund is established

One possible source from which the retirement benefit arises can be the country where the fund is established and located. Some employees perform services for one employer in many different countries (Cook, 2014). To tax the subsequent retirement benefit in every country where the person rendered services will create uncertainty and administrative difficulties, since different countries would tax the same pension (United Nations, 2011). The source of retirement benefits will then be the place where the payments originate, which will be the country where the retirement fund is located, which is the preferred view of the UN.

There are, however, other views which indicate that it would be difficult to justify treating the country where the fund is established as the source when the retiree performed little to no work in that country (OECD, 2017a:347). This will create a mismatch in the general tax policy, since the country where the fund is located will not be the appropriate source, since no physical work may have been performed in that country and no resources were used in that country to perform said work (OECD, 2017a:348).

3.4.2 Country where the person rendered the service

A person saves for retirement while performing services and receives the retirement benefit due to the employee's past services, showing that there is an implicit connection between the retirement benefit and the past employment (Olivier, 2018). Employers also offer retirement benefits to their employees, which further indicates that there is a connection between the retirement benefit and past services rendered. This can suggest that the source could be the country where the person rendered the services. According to Berthier (2020) the source is also deemed to be the country where the person has worked.

In support of this, the country of source of the income from employment is where the person exercised the related employment. The reason behind this is that a person is using the source country's resources in order to earn income and should then be liable for tax in that country (OECD, 2017a:305). If a non-resident worked in the source country for less than 183 days in a tax year and the employer does not have a permanent establishment in the source country, the resident country will have the sole taxing right (OECD, 2017a:38).

Since retirement benefits relate to past employment, the same principles can be applied. The source of retirement benefits would be the country where the person rendered the past services, which is one of the amendments the OECD model suggests countries can add to their double tax agreements (OECD, 2017a:346-347). This will not apply in cases when the person rendered the services for a short amount of time and the retirement fund is located in the country of residence. This would then revert back to the original principle laid out by the OECD model (2017a:39) that the country of residence should tax the retirement benefit.

The OECD model prefers allocating taxing rights to the residence country, but allows for shared taxing rights. In such cases, the preferred view is to allocate the taxing right to the country in which the person rendered the past services. The UN model, as an alternative, prefers to allocate taxing rights to the source country, which is the country where the fund is located.

3.4.3 Problems with source rules and possible solutions thereto

As discussed, it is important to allocate the taxing right of retirement benefits to either the source or the residence country, for which there exist more arguments that the source country may have the right to taxing the retirement benefit rather than the residence country. The allocation of taxing rights to the source country can however lead to an administrative burden of collection of information, assessment of tax, dispute resolution and collection of tax in different countries (Harris, 2013). This can however be addressed through measures such as disclosure of information (either voluntarily or forced), self-assessment, objections and withholding tax.

A possible solution to this, is for countries to add a protocol to their double tax agreements, which specifically allocates taxing rights to either the source or the residence country or to both countries. When such agreements allocate taxing rights to both the residence and source country, the residence country should provide relief to its taxpayer in the form of a tax credit, or that the tax levied by the source country, is limited to a certain percentage (OECD, 2017a:346-347). This will be a solution to the problem, since the two specific countries can take their residents, economic state of the residents, exchange of information and other factors into account in allocating taxing rights.

Countries need to take policy and administration considerations into account before deciding which provision to apply. Factors to be taken into account should include any administrative issues that may arise, the information available to the residence country, the possibility of non-reporting of income and the level of compliance with more than one country's taxation rules (OECD, 2017a:347-348). Countries should also give special consideration to the position of the typical taxpayer who earns retirement fund benefits and moves abroad (Stenlund, 2020). This is an area in which taxpayers can expect further development.

3.5 How the Model Tax Conventions' view compares to South Africa's tax treatment

South Africa has different tax treatment regarding cross-border retirement benefits when it comes to residents and non-residents, as discussed in Chapter 2. The Model Tax Conventions of the OECD and the UN do not specifically distinguish between residents and non-residents of a country with regard to retirement benefits, as is the case with South Africa.

South Africa taxes residents on worldwide retirement benefits. However, a section 10(1)(*gC)* exemption exists for retirement benefits received from a foreign retirement fund, which is a fund not registered in South Africa, and if services were rendered abroad. This means that South Africa provides their residents some relief on the taxation of foreign pension benefits if it is derived from a foreign retirement fund for services rendered abroad. South Africa taxes non-residents on retirement benefits earned in South Africa in the proportion that the person's services were rendered within South Africa, in accordance with section 9(2(*i).* This shows that South Africa aims to give the right to tax the income to the source country, which deviates from the policy to tax residents on worldwide income.

This differs from the overall preferred policy of the OECD model, which allocates the taxing rights of retirement benefits accruing to a person, to the country where the person resides (OECD, 2017a:39). This means that the residence country should have the exclusive right to tax worldwide retirement benefits, unless two countries decide on another allocation method in terms of a double tax agreement.

South Africa further deviates from the OECD policy since they provide residents with an exemption from tax for benefits from foreign retirement funds. According to the preferred OECD principles, South Africa as the country of residence should have the sole right to tax the cross-border benefits, but due to the provisions in section 10(1)(*gC),* this is not the case. The reason for this, according to the National Treasury (2016), is that contributions to local retirement funds receive a tax relief in the form of deductions, but contributions to a foreign fund do not receive a tax relief. It is then appropriate for South Africa to tax the benefits from the local retirement fund and not the benefits from a foreign retirement fund. This provision is also in line with section 10(1)(*o)*(ii) where foreign employment income, up to a certain amount, is exempt from South African tax, which implies that section 10(1)(*gC)* is an extension of this section (Wallrich, 2016). This can however create an administrative burden for South African taxpayers since they may be liable for foreign retirement benefits in another country. According to Hesse (2019), the Davis Tax Committee is concerned that people may misuse these provisions and not genuinely use the savings for retirement, but for other purposes, which indicates that this policy might not be the best solution. This can happen when people invest in offshore investment vehicles, but not for the purpose of saving for retirement due to past services rendered abroad.

The OECD model does however, recognise that there could be arguments to allocate taxing rights to countries other than the resident country. The reason being that not allocating taxing rights to the source country, will cause that country to lose tax revenue on income received by a source of that country (Stenlund, 2020), whether it is the retirement fund located in that country or the services rendered in that country. A strong argument exists to allocate taxing rights to the country where the services were rendered, since the income from employment is generated in that country and the retirement benefit is then also generated in that country (Olivier, 2018). This can however lead to taxpayers misusing the different rules of countries in order to pay less tax (OECD, 2017a:346-348), such as a person performing services in one country which taxes retirement benefits based on residency, but upon retirement changes residency to a country whose tax rules do not tax a resident on foreign retirement benefits. This can lead to the person not paying tax on the retirement benefit at all.

South Africa is also more lenient towards non-residents by only taxing them on retirement benefits when the services were rendered in South Africa and that the retirement benefits were also paid from a local fund. Both these requirements must apply to non-residents before being taxed in South Africa. Double tax agreements between South Africa and a specific country can alter these rules. Such tax treatment is also in agreement with the arguments that the country where services were rendered should have the right to tax the retirement benefit (Wisse, 2012).

When comparing the suggestions by Model Tax Conventions of both the OECD and the UN, it is clear that South Africa does not apply the principles of either of the models in its entirety. South Africa only taxes residents on retirement benefits when the fund is located in South Africa and they are not taxed when the benefits are received from a foreign fund and the services were rendered abroad. This taxation provision is aligned with the UN model approach to allow the source country, instead of the residence country, to tax the retirement benefits. South Africa also taxes non-residents when the person performed services in South Africa and the retirement benefit is paid from a fund in South Africa. This too is in line with the UN model which allows the source country to tax the income. Furthermore, in the case of non-residents, the source country is deemed to be the country where the services were rendered and not only where the fund is located. This is also the preferred alternative view of the OECD model of what the source country is.

For cross-border retirement benefits, South Africa deviates from taxing residents on worldwide income, since foreign retirement benefits are exempt from tax for residents. This tax treatment is not aligned with the preferred OECD model’s view of allocating the sole taxing right to the residence country. The UN however, allows the source country to tax income, and therefore South Africa’s approach is more closely aligned with the UN model’s view. South Africa is therefore not entirely lacking with regard to suggested international Model Tax Convention principles.

3.6 Conclusion

Since more and more employees are working abroad nowadays, they need to understand the tax implications of cross-border retirement fund payments. What follows is a summary of the comparison of the two models. The OECD and the UN have different preferred views as to which country should be allocated the taxing rights of the retirement benefit. South Africa and the OECD share a mutually beneficial relationship and South Africa aims to apply the OECD principles. South Africa is also a member country of the UN and similarly aims to comply with its policies.

The OECD has the preferred view to allocate taxing rights of retirement benefits to the country in which the person resides. The UN however, has the alternative preferred view to allocate the taxing rights to the source country. It is also clear that the source country can either be the country in which the retirement fund is located, or the country in which the past services, relating to the retirement benefit, were rendered. The OECD also allows additional provisions for shared taxing rights between the country of residence and the country of source. We can expect changes in the future as many countries have amended their double tax agreements to add more certainty to the taxing rights of retirement benefits.

South Africa follows a tax treatment that differs from both preferred views. South Africa allows the source country to tax retirement benefits. The deciding factor for the source country is the country where the fund is located for residents and the country where the services are performed for non-residents. South Africa also provides additional tax relief to its residents in terms of retirement benefits which is not entirely in accordance with suggestions made by either the OECD or the UN.

According to the European Union (2019) the most significant difficulties in cross-border transfers of retirement savings are related to taxation. The OECD and the UN address this issue in their Model Tax Conventions and make possible suggestions about dealing with such matters. However, countries may also adapt their domestic law or adjust their double tax agreements in order to make additional provisions regarding cross-border retirement benefit taxation (European Union, 2019). In Chapter 4, South Africa’s tax treatment for cross-border retirement benefits will be compared to those of other international countries.

CHAPTER 4 ANALYSIS AND COMPARISON BETWEEN SOUTH AFRICA AND OTHER COUNTRIES

4.1 Introduction

Since people see their retirement benefits and the taxation thereof as important aspects to consider (Collinson & van Weede, 2012) and many people started working in countries other than their countries of residence (Sunjka, 2020), it is important to consider international tax law with regard to cross-border retirement benefits. The National Treasury (2019) also takes international developments and international best practices into account in order to establish a strategy for the economy of South Africa. According to the SARS (2014), the State Law Advisor from the Department of International Relations and Co-operation will use international tax law to inspect that domestic law is sufficiently aligned with international law.

The countries selected for the international comparison are Australia, Canada, New Zealand and the United Kingdom. All four these countries have been member countries of the OECD for over four decades (OECD, 2020a) which indicates that they have well-established taxation policies in place. Australia, Canada, New Zealand and the United Kingdom are countries with developed economies, whereas South Africa has a developing economy (United Nations, 2020b). It took developed countries many years to develop and implement sound tax practices from which developing countries can learn (Bird & Zolt, 2003:26).

All of the countries selected, have some type of tax consequence for their residents regarding cross-border retirement benefits. All these countries also have a specific policy relating to the taxation of non-residents for retirement benefits arising in that country. Both these aspects, as well as the entire retirement benefit system, from the contribution to receipt of benefit stage, are analysed and compared to how South Africa treats these same aspects. This addresses the last secondary objective of this study of analysing the tax treatment of cross-border retirement funds of these international countries to that of South Africa.

4.2 The tax position of South Africa that will be compared to other countries

From Chapter 2, it is clear that South Africa applies a similar tax treatment for both residents and non-residents in terms of cross-border retirement benefits, i.e. that the person should perform a service in a specific country and that the fund which makes the payment should also be located in that country. However, South Africa deviates from taxing residents on worldwide income when it comes to cross-border retirement benefits since it is exempt. South Africa taxes residents on worldwide retirement benefits, but provides a tax exemption in terms of section 10(1)(*gC)* for retirement benefits received from foreign retirement funds for services performed in a foreign country. This means that if a local South African fund makes the payment of the retirement benefit, it will not be exempt from tax. This leads to a situation where the country in which the fund is located, may tax the income.

This is a form of concession that South Africa provides to its residents, which is also in line with the concession provided by section 10(1)(*o)(*ii) on foreign employment income. Double taxation can occur for a South African resident when South Africa taxes the retirement benefit due to it being received from a local fund, even though the services were rendered abroad and the country where the services were rendered also levies tax on the retirement benefit. However, the resident will subsequently receive a section 6*quat* rebate, which means that South Africa will provide the taxpayer with tax relief from the double taxation.

Non-residents of South Africa are taxed on retirement benefits in proportion to the services rendered in South Africa as well as the amounts being paid from a South African fund (section 9(1)(*k)* of the *Income Tax Act*). However, the location of the fund does not play a crucial role and is not the deciding factor in determining the source, but rather the location of where the services were rendered. This is the tax position of South Africa for residents and non-residents that will be compared to each of the following international countries.

4.3 Australia

4.3.1 Background

The government collects taxes through the Australian Taxation Office. The applicable legislation is the *Income Tax Assessment Act* 27 of 1936 and the *Income Tax Assessment Act* 38 of 1997, with the 1936 Act being gradually rewritten into the 1997 Act. Like South Africa, Australia taxes its residents on worldwide income and non-residents on Australian sourced income (section 6-5 of the *Income Tax Assessment Act*, 38 of 1997). The tax rates for resident individual taxpayers differ from the tax rates imposed on non-resident individual taxpayers (Australian Taxation Office, 2020d).

Australia also has a separate set of tax rules for temporary residents. A temporary resident is someone who is not an Australian citizen, but holds a temporary visa to be in Australia during a specific period (Australian Taxation Office, 2020d). According to KPMG, an international accounting firm, temporary residents are taxed on employment income from all sources derived after arrival in Australia and all Australian sourced investment income, subject to double tax agreements (KPMG, 2019a).

4.3.2 Superannuation benefits taxation

In Australia, reference is made to superannuation as the money set aside during a person's career for retirement. Employees pay money into superannuation funds, which in turn invest the funds to generate future returns (Australian Taxation Office, 2020c). The tax rules for superannuation of benefits is therefore the same as retirement benefits, with it just being called superannuation.

Employees receive a tax deduction for contributions made to a superannuation fund in addition to employer contributions. These contributions should not exceed a concessional contributions cap (Harper, 2012). The concessional contributions cap depends on a taxpayer's age. The reasoning behind giving employees a tax deduction for contributions made, is to encourage them to make a greater voluntary contribution towards their superannuation fund while still working (Reinhardt & Steel, 2006). Australia taxes the superannuation provider or fund on these contributions. The fund is also taxed on the earnings of the invested amounts, generally at a rate of 15%, except for dividends which are tax-free (Harper, 2012).

Once the superannuation fund pays the benefits to a person, the taxation thereof depends on the person's age. If the person is 60 years and older and the superannuation benefit is the sole source of income, the person will not be liable for tax when the retirement benefit is received (Australian Taxation Office, 2020b). The government added this provision into the legislation in 2007 to dramatically simplify superannuation and to improve retirement income for people at old age (Reinhardt & Steel, 2006).

If a person is between the ages of 55 and 59, Australia taxes the superannuation at that person's marginal tax rate, less a 15% tax offset, which also provides some tax relief. If a person younger than 55 withdraws the superannuation and did not become permanently incapacitated, the superannuation will be taxed at the person's marginal tax rate (Moneysmart, 2020). These tax concessions are made with the purpose to encourage Australians to save and make provision for their retirement (section 280-1(2) of the *Income Tax Assessment Act*, 38 of 1997). Therefore, the superannuation fund is taxed on a continuous basis and tax is not only imposed when the benefits are received.

4.3.2.1 Cross-border superannuation

When an Australian tax resident has worked outside the country and earns retirement benefits from a source outside Australia, that benefit will be taxable in Australia, since the country taxes residents on worldwide income. If the person paid foreign taxes on the benefit or the foreign fund withheld tax from the payment, the person can get a tax offset to reduce the Australian income tax (section 770-5 of the *Income Tax Assessment Act*, 38 of 1997). This is done to ensure that no double taxation of the same income occurs. This tax treatment is also subject to double tax agreements that Australia may have with another country, which can specifically allocate taxing rights (KPMG, 2019a).

If a resident's foreign retirement benefits are paid from a country with which Australia have a double tax agreement, the Australian Taxation Office encourages residents to make the necessary arrangements with the fund, to not have tax withheld from future payments from that country (Australian Tax Office, 2020a). This demonstrates that Australia intends on taxing their residents on worldwide superannuation or retirement benefits. This practice is aligned with the preferred view of the OECD as discussed in Chapter 3. This shows that Australia's view is to tax its residents on their worldwide income, irrespective of where the person rendered the services or where the fund is located.

On the other hand, Australia taxes non-residents on Australian sourced income, which the *Income Tax Assessment Act* (27 of 1936) defines. It states that an amount shall be deemed to be income derived from a particular source, if the person derived the amount of income by reason of being beneficially entitled to that amount that is derived from that source (section 6B(2A)). According to Hall and Wilcox (2017), Australia has a system which prescribes when income is from a source in Australia. Income is from a source in Australia when it is derived from the place of employment which is in Australia or the fixed place of business is situated in Australia.

When a non-resident performs services in Australia, their Australian employer may be required to make superannuation contributions to a superannuation fund on their behalf. When that person eventually leaves Australia, they can claim that superannuation benefit back as a "departing Australia superannuation payment" and that payment will be taxed by Australia before the person receives it (Australian Taxation Office, 2020a). The government implemented this provision in 2002 with the aim to cause less inconvenience for superannuation funds to maintain accounts for people who have permanently left Australia and only performed services for a limited period. It also caused inconvenience for such employees leaving Australia since, before the rule was implemented, they were prohibited to transfer these funds to their country of residence (Robinson, 2002).

The person who receives a "departing Australia superannuation payment" will be liable for tax upon this payment. However, the fund withholds the tax on the payment instead of the person having to pay the tax over to the Australian Taxation Office. This finalises the departing person's tax obligations in a more practical manner (Robinson, 2002). The same rules apply for temporary residents transferring their superannuation funds to their original country of residence.

If a non-resident cashes out benefits from an Australian superannuation fund, the benefit is deemed to be sourced in Australia (Miles, 2010). This indicates that the source of the superannuation fund is the fund being located in Australia, which is the main consideration for allowing a country to tax the income. It appears that Australia considers the retirement benefit as investment income rather than remuneration.

In conclusion, Australia aims to tax residents on their worldwide retirement benefits, but will provide a tax credit when double tax occurs. Australia also taxes non-residents on retirement benefits if the fund is located in Australia since it is deemed to be from an Australian source. These policies are however subject to double tax agreements that Australia may have entered into with other countries.

4.3.3 Comparison with South Africa

4.3.3.1 Residents

Both South Africa and Australia tax their residents on worldwide income, which can include benefits from retirement funds. For South African residents, there is however an exemption on retirement benefits received from foreign funds. Australia however, tax their residents on their worldwide retirement benefits. The fact that the Australian Taxation Office encourages residents to arrange not to have tax withheld from retirement benefits, shows that Australia aims to have the sole taxing rights on cross-border retirement benefits. This tax treatment differs from South Africa in the sense that South Africa exempts certain receipts from foreign funds from tax, whereas Australia taxes all receipts from foreign funds. Australia does provide tax relief when double taxation occurs, similarly to South Africa, however it is not their main intention as they aim to have the sole taxing rights on cross-border retirement funds.

In principle, for residents of the country, South Africa does not tax residents on benefits from foreign funds, whereas Australia aims to do so. This conclusion does not however, take into account any provisions from double tax agreements, which may affect the tax treatment. This reveals a difference in the tax treatment of South Africa and Australia when it comes to residents and shows that South Africa provides more tax relief to their residents for foreign retirement benefits than Australia.

Further differences between the South African and Australian retirement system is that South Africa taxes retirement benefits upon receipt of the benefit upon retirement. The person will receive a once-off R500 000 exemption on the lump sum. Australia taxes the growth in the superannuation benefit throughout the contribution period, by taxing the superannuation fund on contributions received and growth in the fund. Australia subsequently entirely exempts a person older than 60 years from tax, if the retirement benefit is the only source of income while persons between 50 and 59 receive a 15% tax relief (Australian Taxation Office, 2020b). This shows clear differences between the tax systems of the two countries.

4.3.3.2 Non-residents

South Africa taxes non-residents on retirement benefits in proportion to the services rendered in South Africa. Australia only taxes non-residents if the person receives retirement benefits from an Australian fund, which shows that the location of the retirement benefit is based on the location of the fund. Australia will not tax a non-resident on retirement benefits in its resident country if it is not received from an Australian fund. This differs from South Africa's tax treatment for non-residents, where South Africa also regards the location of the services rendered as a main factor to determine the source.

4.3.4 Conclusion

There are many differences between the taxation of the South African retirement system and the taxation of the Australian superannuation system, especially when looking at the treatment for residents and non-residents and the taxation of the retirement benefit itself. This comparison illustrates that South Africa's tax treatment for residents is more lenient when it comes to cross-border retirement benefits when compared to Australia's tax treatment of superannuation funds. Regarding the position of non-residents, South Africa only taxes non-residents when the person rendered services in South Africa and the payment is also made from a South African fund, whereas Australia uses the location of the superannuation funds as the deciding factor. With multiple differences between the two systems, it does not appear as if South Africa's tax treatment is comparable to that of Australia with regard to the taxation of cross-border retirement benefits.

4.4 Canada

4.4.1 Background

Residents of Canada pay taxes at both the federal level and the provincial level. The Canada Revenue Agency (CRA) collects taxes. The CRA also collects income taxes on behalf of all provinces and the *Income Tax Act* of 1985 governs income taxes (Canada Revenue Agency, 2020a).

At federal level, Canada taxes their residents on worldwide income according to section 2(1) of the *Income Tax Act*, 1985. Section 126(1) states that residents are entitled to a potential credit for foreign taxes paid on income from foreign sources. According to a tax summary by

Pricewaterhouse Coopers, double tax agreements between Canada and other countries can also provide residents with relief from double taxation (PWC, 2020).

Canada taxes non-residents on certain types of Canadian-source income at the same rate that residents are taxed (KPMG, 2020a). Such income includes Canadian employment income, business income and gains on disposal of Canadian property (section 2(3), 1985). If a non-resident receives other income such as interest, rent, royalties and management fees, amongst others, the resident fund or person paying the amount to the non-resident will withhold a withholding tax of 25% in accordance with section 212.

4.4.2 Retirement benefits taxation

A person can receive retirement benefits in Canada either from government retirement benefit schemes or private pensions (Golombek & Francis, 2019). Employees and employers are allowed to deduct government plan contributions from taxable income (Canada Revenue Agency, 2019). Employees are also allowed to deduct contributions to registered pension plans, as per section 8(1)(m) of the *Income Tax Act*, 1985, subject to limitations as set out in section 146(5). This is motivation for retirees to contribute in order to receive an enhanced pension in future years (Golombek & Francis, 2019). Canada wants to motivate employees to contribute to a voluntary pension in addition to the government funds to further boost their future retirement income (OECD, 2019:31). Unlike Australia, Canada does not tax the retirement fund on the contributions received or on the growth in the fund.

Benefits from government retirement funds are based on the contributions made while employed and will be payable from the fund to the person for the remainder of the person’s lifetime. Canada will tax a person on the benefits received from these funds in the year(s) that the benefits are received (Golombek & Francis, 2019). Retirement benefits paid from other pensions registered retirement savings plans, such as from an employer or private pension fund, will be included in a retiree’s income, in accordance with section 146(8) of the *Income Tax Act* (1985). This means that all retirement income is taxable (Biro, 2019) in the year(s) of receipt.

Section 118(3) of the *Income Tax Act*, 1985 does however, permit the taxpayer to deduct a percentage of that income as a pension credit if it was received from eligible pension, superannuation or annuity payments (Biro, 2019). A retiree is also entitled to claim an age tax credit once they reach the age of 65 (Golombek & Francis, 2019), which Whitehouse (1999) calls an extra grant as special tax treatment for pensioners.

4.4.2.1 Cross-border retirement benefits

Canada taxes residents on worldwide income, which can include retirement benefits from a source that is not within Canada, such as services not rendered in Canada (Golombek, 2019). Taxpayers therefore have to include the gross foreign retirement benefit received on their tax returns.

The Tax Court and Appellate Court in Canada both confirmed this principle. In the case of *Reyes v Canada* (2019), the taxpayer worked outside Canada and immigrated to Canada as his country of residence. He started to receive pension benefits from his work performed outside Canada and claimed an offset on his tax return. The Tax Court found that the country of residence, which is Canada, has the right to tax the foreign retirement benefits. The Appellate Court also found that the country of residence is entitled to tax the resident on pension income from another country, which confirms that Canada taxes residents on worldwide retirement benefits.

If the foreign retirement fund withheld taxes before paying the amount to the Canadian resident, a case of double taxation exist. The Canada Revenue Agency does not refund the taxes paid to a foreign country, but rather allows the taxpayer to claim a foreign tax credit (Canada Revenue Agency, 2020b). The taxes withheld by the foreign fund can also be terminated if the taxpayer provides the fund with a certificate of Canadian residency, depending on which country it is and whether there is a double tax agreement in place (Canada Revenue Agency, 2020b).

Conversely, section 212(h) of the *Income Tax Act* (1985) addresses retirement benefits received from Canada by a non-resident. The resident in Canada, which is the retirement fund, withholds 25% on the amount paid to a non-resident. The rate of 25% can be reduced in terms of the existence of a double tax agreement (Golombek & Francis, 2019), commonly to 15% (Heath, 2020). This provision indicates that the fund paying the benefits to the non-resident is the source of the retirement benefits.

In conclusion, Canada taxes residents on their worldwide retirement benefits, but will provide a tax credit in the case of double taxation. Canada taxes non-residents on retirement benefits paid from retirement funds in Canada at a rate of 25%, subject to a lower rate according to a double tax agreement.

4.4.3 Comparison with South Africa

4.4.3.1 Residents

Both South Africa and Canada tax their residents on worldwide income, which includes retirement benefits from foreign sources. South Africa exempts residents from tax on retirement benefits from foreign funds, which Canada does not. The country where the fund is located therefore has the taxing rights for South African residents, but for Canadian residents the country of residence has the taxing rights. Both South Africa and Canada provide their residents with a tax credit when double taxation occurs.

Canada does not have the same relief for its residents that South Africa provides meaning South Africa shows more leniency to its residents. The tax treatment between these two countries differ, since South Africa initially exempts retirement benefits from foreign funds, whereas Canada aims to tax such benefits, and will only provide tax relief in the case of double tax. This tax treatment will also be subject to existing double tax agreements between the applicable countries involved.

4.4.3.2 Non-residents

South Africa taxes non-residents on retirement benefits if the person rendered services within South Africa. Canada, however, taxes non-residents if the person received the retirement benefits from a Canadian fund, since the fund withholds a certain percentage of tax before paying the benefit out to the non-resident. This also differs from the tax treatment of South Africa, since the location of the fund plays a leading role in Canada's tax treatment of cross-border retirement benefits and not necessarily the location of where the services were rendered.

4.4.3.3 Conclusion

South Africa and Canada's retirement systems are more alike and comparable, since neither countries levy any tax on the retirement fund itself for contributions by the members or the growth of the fund. Both countries also provide tax relief for contributions to funds in the form of a tax deduction in order to motivate employees to save for retirement. Furthermore, both countries provide tax relief upon the receipt of the retirement benefit; South Africa in terms of the R500 000 once-off exemption and Canada in terms of the age tax credit. There are however differences in the tax treatment of cross-border retirement benefits with regard to residents and non-residents.

For residents, Canada aims to tax worldwide retirement benefits, but will allow tax relief when double tax occurs on cross-border benefits. South Africa exempts retirement benefits from foreign funds, showing that South Africa is more accommodating to residents regarding cross-border retirement benefits. For non-residents, South Africa imposes tax when the person performed services in South Africa, which is a requirement to be taxed in South Africa, apart from receiving funds from a South African retirement fund. Canada, however, only taxes non-residents when they receive retirement benefits from a Canadian fund. Consequently Canada bases their decision in determining the source of the retirement benefits, for non-residents, on the location of the fund, while South Africa uses the location of where the services were rendered as the deciding factor.

The tax systems between South Africa and Canada are comparable despite the differences between the tax treatment of residents and non-residents when it comes to cross-border retirement benefits.

4.5 New Zealand

4.5.1 Background

The Inland Revenue Department (IRD) collects taxes on behalf of the Government of New Zealand (Inland Revenue Department, 2020a). The *Income Tax Act* 97 of 2007 governs income tax in this country. Tax residents of New Zealand are liable for tax on their worldwide income and non-residents are taxed on income they earn from New Zealand sources (Inland Revenue Department, 2020b).

4.5.2 Retirement benefits taxation

New Zealand does not have an official retirement age, but most people aim to retire at the age of 65. Its retirement income system comprises a universal public pension which is paid to all residents over 65 as well as a voluntary pension saving scheme that individuals can use to enhance their income, over and above the public pension (Cortese & Glynn, 2006; Wilmington plc, 2017).

New Zealand does not tax an employee on the contribution that an employer makes towards superannuation contributions for the employee’s benefit (section CX 49 of the *Income Tax Act*, 97 of 2007). There are nevertheless no deductions or tax incentives for the employee to encourage saving for retirement and contributors receive no benefit for the fact that they contribute to a fund. New Zealand also taxes the retirement funds on the investment returns and earnings and such taxes are deducted from the pension account (OECD, 2015). However, upon retirement, the payment of benefits from superannuation funds and retirement funds are exempt from tax (Cortese & Glynn, 2006) regardless of whether it is received in the form of an annuity, lump sum or pension (OECD, 2015). This indicates a different tax system, since the value of the retirement benefit has already been taxed by the time it is paid out.

4.5.2.1 Cross-border retirement benefits

Since residents are taxed on worldwide income, residents will be taxed on retirement benefits received from foreign retirement funds. If a resident makes contributions to a non-New Zealand retirement fund, the retirement benefit will be taxable (KPMG, 2019b), which is different from how residents are taxed on local retirement benefits. According to section LJ 1 of the *Income Tax Act* 97 of 2007, a resident of New Zealand can claim a tax credit for foreign taxes paid on foreign-sourced income, subject to double tax agreements.

New Zealand used to tax residents annually on the capital gain of the foreign retirement fund regardless of the location of the fund or services rendered. However, the Inland Revenue Department noticed that many resident taxpayers ignored this rule. In 2013, new rules came into effect where residents are taxed when they transfer money out of their foreign retirement fund, as a lump sum or regular payment, in order to serve as an anti-avoidance measure (Clement, 2013). This will affect taxpayers with a retirement fund in a country other than New Zealand, who subsequently transfer the benefit from that fund to a New Zealand fund.

For a non-resident, section HD 28 of the *Income Tax Act* (97 of 2007) determines that if a non-resident derives a pension or annuity under a scheme established in New Zealand, the income tax payable must be withheld from the payments made to the person and must be paid over to the tax authorities on the person's behalf.

In conclusion, New Zealand does not tax its residents on retirement benefits received from local funds and as a result does not provide tax deductions or incentives for contributions to these funds. Residents are however taxed on retirement benefits received from foreign funds, subject to double tax agreements. If double tax occurs and it is not resolved by the double tax agreement, the taxpayer will receive a foreign tax credit. Non-residents are taxed on retirement benefits received from New Zealand funds.

4.5.3 Comparison with South Africa

4.5.3.1 Residents

South Africa and New Zealand both tax their residents on worldwide income, which includes retirement benefits from foreign sources. South Africa exempts residents from tax on retirement benefits from foreign funds, which is a tax relief that South Africa provides its residents by granting the taxing right to the country in which the fund is located.

New Zealand taxes its residents on foreign retirement benefits, but not on local retirement benefits. However, New Zealand does not exempt foreign retirement benefits from tax, which reveals a difference in the tax treatment between South Africa and New Zealand. South Africa does not tax their residents on certain retirement benefits from foreign funds, while New Zealand does exercise this tax treatment, albeit subject to double tax agreements. This indicates a difference between the tax treatment of South Africa and New Zealand with regard to cross-border retirement benefits received by residents.

There are additional differences between the tax systems for retirement benefits between South Africa and New Zealand namely that South Africa provides a deduction to taxpayers for contributions made to retirement funds. New Zealand does not provide such a relief to taxpayers. New Zealand also taxes the retirement fund on investment returns while South Africa does not tax the retirement funds on such returns. Then again New Zealand does not tax taxpayers upon receipt of the benefit, but South Africa residents are subject to taxation of such payments, due to the tax relief given through deductions.

4.5.3.2 Non-residents

South Africa taxes non-residents on retirement benefits if the person receives funds from a South African fund in relation to the services rendered in South Africa. New Zealand, on the other hand, taxes non-residents if they receive retirement benefits from a New Zealand fund. The location of the fund is the deciding factor that determines when New Zealand is able to tax the retirement benefit. This differs from South Africa, where the country in which the services were rendered also plays a significant role in determining which country can tax the retirement benefits.

4.5.3.3 Conclusion

When comparing South Africa to New Zealand, there are differences between the tax treatment with regard to cross-border retirement payments for residents and non-residents. South Africa shows more leniency towards residents with regard to cross-border retirement funds, by exempting benefits from foreign funds from taxation. New Zealand does not provide this type of relief to their residents. New Zealand does not however, tax their residents on local retirement benefits, which is relief provided to taxpayers while South Africa does not extend this courtesy to their residents.

For non-residents, the tax treatment with regard to cross-border retirement benefits also differ, since South Africa taxes non-residents if the services were performed in South Africa and New Zealand taxes non-residents only when the payment in made from a fund located in New Zealand. There are also many other differences between the tax systems, such as the fact that New Zealand does not tax residents on local retirement benefits unlike South Africa, which shows that the tax treatment is unlikely to be comparable.

4.6 United Kingdom

4.6.1 Background

Taxation in the United Kingdom involves payment to central government, devolved government and local government. Income tax is primarily paid to the central government and is collected by the United Kingdom's tax authority, Her Majesty's (HM) Revenue and Customs (HM Revenue & Customs, 2020b). The *Income Tax Act* of 2007 (c. 3) governs income tax.

The United Kingdom (UK) taxes individuals who are resident and domiciled in the UK on their worldwide income. The UK taxes non-residents on UK sourced income (KPMG, 2020b). The UK has another set of rules for taxpayers that are UK tax residents but are not domiciled in the UK and not deemed to be domiciled in the UK. The remittance basis of taxation applies to such taxpayers, which means non-UK income may be taxed when remitted to the UK, i.e. taken in, used in or brought to the UK, and not when the income arises (section 809B and 809I, *Income Tax Act*, 2007 (c. 3)).

4.6.2 Retirement benefits taxation

The tax authority tops up a person's contribution towards a registered pension fund. The reason for this is that taxpayers make contributions to retirement funds from income that was already taxed and the tax authorities are refunding that income tax (Braun, 2020:9). The retirement fund will claim this money and credit it to the taxpayer's account. A further tax relief on retirement fund contributions is given to the taxpayer in the form of allowable deductions for gross employee contributions to registered pension plans (KPMG, 2020b), or even a foreign pension plan that meets certain criteria (HM Revenue &Customs, 2020a). This means an employee gets a deduction for the portion that was contributed by themselves as well as for the portion that was grossed-up by the tax authority. The deductions allowed are limited to a percentage however, an additional tax charge will arise if the contribution limits are exceeded (KPMG, 2020b).

Income and capital gains on the retirement fund, i.e. the growth, are tax-free for the taxpayer. Upon retirement, UK taxpayers used to be restricted on the amount that they could withdraw as retirement benefits, but most restrictions have been lifted, giving retirees more control over the amount they withdraw from the retirement fund (Braun, 2020:1-2).

When a taxpayer receives the retirement benefits, it is added to their taxable income. A taxpayer is liable for tax payment if the total value of the retirement benefit exceeds a specified amount, which means a certain portion of the retirement benefit is exempt from tax (HM Revenue &

Customs, 2020a). The fund withholds the tax before it is paid to the retiree. Retirement benefits are taxed due to the relief provided when contributions were made.

4.6.2.1 Cross-border retirement benefits

The UK taxes residents on worldwide income and from April 2017, the entire foreign retirement benefit payable to a UK resident will be chargeable to tax. Before then, only 90% of the amount used to be taxable (Chartered Institute of Taxation, 2020). The change from 90% to 100% of the foreign retirement benefit being taxable was made in order for the tax treatment of foreign retirement benefits to be more closely aligned with the local tax regime (Robins, 2016). This means that for a resident, any retirement benefits will be taxable, regardless of the location of the fund or where the services were rendered. According to HM Revenue and Customs (2017), pensions paid to UK residents will be taxed in the same way whether the source is based in the UK or abroad. Non-domiciled individuals who use the remittance basis of tax will be taxed on foreign retirement benefits when the benefit is transferred to the UK (HM Revenue & Customs, 2017).

If a UK tax resident paid foreign taxes on the foreign retirement benefits, the taxpayer can claim the foreign taxes, paid back as a foreign tax credit to reduce their UK tax liability (Chartered Institute of Taxation, 2020). This is subject to any double tax agreement between the UK and the other country.

However, for a non-resident who is only taxed on UK source income, the UK pension provider may deduct UK income tax from any payments from a fund situated in the UK (MES, 2020). Double tax agreements can then prevent a situation of double taxation and will usually provide one country with taxing rights. The majority of double tax agreements that the UK has entered into state that a non-residents pension should only be taxable in the country of residence, which agrees with the HM Revenue and Customs view below. A person will need to inform HM Revenue and Customs that income will be taxed in the country of residence and they will inform the UK retirement fund not to deduct tax from the payments made (MES, 2020).

According to HM Revenue and Customs (2020a), when a taxpayer is not a UK resident, they will usually not pay tax on retirement benefits, except when it is a UK civil service pension, which is always taxed in the UK. The taxpayer may then be liable for tax in the country of residence.

In conclusion the United Kingdom taxes residents on worldwide retirement benefits and for non-residents their country of residence will have taxing rights on the retirement benefits arising from the UK.

4.6.3 Comparison with South Africa

4.6.3.1 Residents

Both South Africa and the United Kingdom tax their residents on worldwide income, which can include benefits from a retirement fund. South Africa exempts their residents from tax on benefits received from foreign retirement funds. The United Kingdom does however not give a similar exemption for foreign retirement benefits to their residents and taxes residents on worldwide retirement benefits, providing tax relief only in the case of double taxation. This shows a difference between the principles that South Africa does not tax residents on benefits from foreign funds, whereas the United Kingdom aims to do so.

4.6.3.2 Non-residents

South Africa taxes non-residents on retirement benefits in proportion to the services rendered in South Africa as well as when a South African fund makes the payment. The United Kingdom, however, only taxes non-residents if they receive retirement benefits from the UK, but aims for the country of residence to have the taxing rights on such benefits. The UK therefore aims not to tax non-residents on retirement benefits arising in the UK, whether it is from a fund in the UK or due to services performed in the UK. This shows a difference between the countries' tax treatment with regard to cross-border retirement benefits for non-residents.

4.6.3.3 Conclusion

South Africa and the United Kingdom's retirement system is more alike and comparable, since both countries levy tax on the taxpayers upon retirement and not during the growth phase. Both countries also provide some sort of tax relief for contributions made to funds. South Africa provides a tax deduction and in the United Kingdom, the tax authority tops up an employee's contributions and also provides a tax deduction to motivate employees to save for retirement. Furthermore, both countries provide tax relief upon the receipt of the retirement benefit by exempting a specified amount of the retirement benefit from tax. There are however differences in the tax treatment of cross-border retirement benefits with regard to residents and non-residents.

For residents, the UK aims to tax worldwide retirement benefits, but will give tax relief when double tax arises due to cross-border benefits. South Africa exempts retirement benefits from foreign funds, showing that South Africa is more accommodating to residents regarding cross-border retirement benefits. For non-residents, South Africa taxes non-residents when services were performed in South Africa as well as when funds were received from a South African retirement fund. The UK, however, intends to give the resident country the taxing rights on the retirement benefits from the UK source, which is also aligned with the preferred OECD view as stated in Chapter 3.

The tax systems between South Africa and the United Kingdom are therefore comparable. There are however differences in terms of the tax treatment between residents and non-residents when it comes to cross-border retirement benefits.

4.7 Summary of tax treatment between countries

The following table provides an overview of the differences between the tax treatment of cross-border retirement benefits between South Africa and the international countries discussed above. The tax positions in the table are subject to provisions of a specific double tax agreement that the country can have with another country.

Country	South Africa	Australia	Canada	New Zealand	United Kingdom
Taxation of residents	On worldwide income	On worldwide income; separate rules for temporary residents	On worldwide income	On worldwide income	On worldwide income; separate rules for residents not domiciled in the UK
Taxation of non-residents	On South African sourced income	On Australian sourced income	On Canadian sourced income	On New Zealand sourced income	On United Kingdom sourced income
Taxation on growth of benefit while in retirement fund	None	The superannuation fund is taxed	None	The retirement fund is taxed	None
Benefit/Deduction for taxpayer for contributions	Yes, subject to limitations	Yes, but it is capped	Yes, subject to limitations	None	Yes, on own contribution and well as government top up, limited to a certain %
Taxation upon receipt	Yes, R500 000 is however exempt	Yes, dependent on age; persons over 60 usually do not pay tax	Yes, with an exempt amount	None	Yes, with an exempt amount

Cross-border for residents	Receipts from foreign funds are exempt when services were rendered abroad	Taxable in Australia; intends to have sole taxing right	Taxable in Canada; tax credit in the case of double taxation	Taxable in New Zealand; tax credit in the case of double taxation	Taxable in the United Kingdom; tax credit in the case of double taxation
Cross-border for non-residents	Taxed in South Africa when fund is located in South Africa and when services were rendered in South Africa	Taxed when fund is located in Australia	Taxed when the fund is located in Canada	Taxed when fund is located in New Zealand	Taxed when fund is located in the United Kingdom; however aims to allow country of residence the right to tax

Table 4-1: Comparison of South Africa and other international countries

4.8 Conclusion

From the analysis of the legislation of Australia, Canada, New Zealand and the United Kingdom, it is clear that there are differences in the tax systems as well as in the tax treatment between residents and non-residents for receipts from retirement benefits. Australia and New Zealand's tax system differs the most from South Africa in terms of the way that retirement benefits are taxed, since the retirement fund is taxed on the growth of the benefits, which is not the case with South Africa, Canada or the United Kingdom.

None of the countries provide their residents with an exemption for retirement benefits from foreign funds as is the case in South Africa with the application of section 10(1)(*gC*) of the *Income Tax Act*. This is therefore a relief provided by South Africa that does not occur in other countries, which makes South Africa more lenient when it comes to cross-border retirement benefits for their residents.

South Africa also seems more lenient when it comes to taxing non-residents on cross-border retirement benefits. Most countries will tax a non-resident when the funds were received from a fund located in that country, or will allow the country of residence to tax the income. South Africa on the other hand only taxes non-residents in proportion to the services that were rendered in South Africa and if the benefit is received from a South African fund. South Africa does not provide for the country of residence to tax the income, except when allocated to a country by a stipulation in a double tax agreement between South Africa and another country.

Australia also applies different tax treatments for residents and non-residents when it comes to retirement benefits. It taxes residents on the retirement benefit paid from funds in the country of residence and non-residents on the benefits from funds in the country where the fund is located. Canada also taxes residents based on the country of residence, but provides a tax credit when double taxation occurs. Non-residents are taxed based on the location of the fund, which is also indicative of different tax treatment between residents and non-residents. New Zealand also exhibits different tax treatment between residents and non-residents, where residents are not taxed on local benefits, but only on foreign benefits and non-residents are taxed based on the location of the fund. Nonetheless, all of these countries follow the view of taxing the resident on worldwide retirement benefits and non-residents on retirement benefits from a fund located in the country where the benefits are earned.

The United Kingdom appears to be the only country where the aim of its legislation is to tax both residents and non-residents in the same way, which is that the country of residence should have the right to tax the retirement benefits. In conclusion, South Africa's tax treatment relating to cross-border retirement benefits is unique and not the same as those of Australia, New Zealand, Canada or the United Kingdom, due to the fact that no other country taxes their residents and non-residents in same the way that South Africa taxes these parties. In terms of residents, South Africa is more accommodating to provide relief regarding cross-border retirement benefits. South Africa is also more lenient towards taxation of non-residents regarding retirement benefits, with the location of where the relating services were performed as a key deciding factor and not purely whether the fund was located in South Africa. From the above analysis of the tax approaches regarding cross-border retirement benefits, South Africa clearly exhibits a different tax treatment in comparison to the other international countries, especially with regard to the relief provided to residents.

CHAPTER 5 SUMMARY AND CONCLUSION

5.1 Summary

This mini-dissertation dealt with an international comparison of the tax treatment by South Africa with regard to cross-border retirement benefits. Chapter 1 introduced the study and provided background information regarding the research and set out the actuality of the topic. The taxation of cross-border retirement benefits is an actual topic, since many people are employed internationally (Brewster *et al.,* 2019) which has an effect on the taxation of benefits that arise from such employment.

The research for this mini-dissertation was done by performing a literature review of existing available sources, such as tax legislation of South Africa and other international countries. Other primary resources such as books, journal articles and internet articles were also examined. This was a qualitative research study since no quantitative data was researched or used. Primary sources were interpreted in order to reach findings, which means an interpretivistic approach was followed. The study of the development of tax legislation in South Africa in chapter 2 was qualitative research.

South Africa does not currently tax cross-border retirement benefits in accordance with the residence tax base adopted in 2001. Foreign retirement benefits received by residents may not be taxed at all, which can lead to lost tax revenue for South Africa. This led to the research question of the study, which is how the current South African tax treatment of cross-border retirement benefits compare to international standards, such as Model Tax Conventions and tax legislation of comparable countries. The main and secondary objectives of this mini-dissertation were addressed in each of the chapters.

5.1.1 South Africa’s tax treatment of cross-border retirement benefits

Since South Africa has experienced extensive tax changes during the last two decades, this had an impact on how a taxpayer’s retirement benefits are taxed. A retirement benefit can consist of a payment, whether in the form of an annuity or a lump sum, which a retiree receives from a pension fund, pension preservation fund, provident fund, provident preservation fund or a retirement annuity fund.

South Africa has a certain set of tax rules for the taxation of these funds for both residents and non-residents. Chapter 2 addressed the objective to analyse the development of the South African tax legislation with regard to retirement benefits, with a specific focus on cross-border retirement benefits. This analysis was done from 2001, when South Africa moved from a source based tax system to a residency based tax system, until the latest tax legislation amendments. In Chapter 2 it was noted that South Africans worry about the tax implications of retirement (Nelson, 2016), also when a cross-border element is involved.

An overview of the South African tax system and the change from source based to residency based was discussed. The reason for this extensive change was also researched and discussed. Further changes to tax legislation with regard to retirement benefits over the years was also analysed and discussed in order to establish what the tax treatment in South Africa is.

From this analysis, it was concluded that South Africa has tax rules for the tax treatment of the cross-border retirement benefits for residents and non-residents. South Africa taxes residents on worldwide income, which includes worldwide retirement benefits. The retirement benefit is taxed on a separate tax table after receiving a once-off exemption. Relief is provided to resident taxpayers for retirement benefits received from a source outside the Republic through section 10(1)(*gC)* of the *Income Tax Act.* This section has undergone many amendments over the years. It first stated that such benefits that are not from a source in South Africa, in consideration of past employment outside South Africa, was exempt from tax. The source was deemed as the country where the services were rendered in terms of section 9.

In 2016, however, an amendment was made to section 10(1)(*gC).* This amendment caused that only retirement benefits from a foreign retirement fund is exempt from tax. If a taxpayer exercised employment abroad while contributing to a South African retirement fund, the benefits will not be exempted from tax in the ratio of time that the person worked abroad (Gouws, 2017). This means that, for South African tax residents, cross-border retirement funds are not taxed in line with the residence-based tax principle that South Africa adopted in 2001.

South Africa taxes non-residents on South African sourced income as set out in section 9 of the *Income Tax Act*. Section 9(2)(*i)* deems retirement benefits to be from a South African source when the service that gave rise to the retirement benefit was rendered in South Africa. If the person only rendered the service partly in South Africa, that ratio of the total period of service will be deemed to be from a South African source. The tax treatment for non-residents is that the source of retirement benefits will be the country where the service was rendered as well as the location of the fund, with the location of the fund not being the only deciding factor. This South African tax treatment was then further compared to international policies and legislation.

5.1.2 Comparison to Model Tax Conventions

Furthermore, Chapter 3 dealt with the international view of organisations such as the OECD and the UN. The OECD's basic principle with regard to retirement benefits is that the country of the person's residence should have the taxing right to avoid an administrative burden being placed on the taxpayer (OECD, 2017a:343). This can however cause the source country to lose tax revenue on income that was earned in that country (Stenlund, 2020). A taxpayer can furthermore make use of different countries' tax rules to avoid paying tax.

In addition, the OECD acknowledged that another basis for allocating taxing rights can exist, such as giving the source country whole or partial taxing rights. The UN also support the view that the source country should be allocated the taxing rights. The UN recognises the source country as either be the country where the retirement fund is located or the country where the services were previously rendered (OECD, 2017a:348).

South Africa does not tax residents on cross-border retirement benefits and taxes residents on South African sourced retirement benefits. This shows a difference in policy from the preferred view of the Model Tax Conventions, which addressed a further objective of the study.

5.1.3 Comparison to tax treatment of other countries

Another objective of the study, was to compare South Africa's abovementioned tax treatment to those of other international countries. In Chapter 4, a comparison was made against the tax treatment of Australia, Canada, New Zealand and the United Kingdom.

Australia has a tax system for retirement benefits that is different to the tax system of South Africa. Australia does not aim to tax a person's retirement income if the person is older than 60 and has no other source of income. South Africa does not provide such relief, except for a once-off R500 000 exemption upon receipt of the benefit. Australia also taxes the superannuation fund on the growth in the fund contrary to South Africa. Australia also aims to have sole taxing rights over cross-border retirement benefits for residents, where South Africa provides relief to their residents for foreign retirement benefits earned. South Africa taxes non-residents on retirement benefits when the service was rendered in South Africa as well as when the fund is located in South Africa. Australia only taxes non-residents when the payment is made from an Australian fund. South Africa's tax treatment differs from that of Australia.

Canada and South Africa have tax systems that are more comparable, since neither country taxes the retirement fund on the growth in the fund. Canada's tax treatment of residents and non-residents are however different from South Africa. South Africa provides residents with relief from benefits from foreign retirement funds, which Canada does not provide. Canada will only provide relief to residents when double taxation occurs. The tax treatment for non-residents are also different. South Africa taxes non-residents if the person rendered services in South Africa and if the benefits are received from South African funds, whereas Canada taxes non-residents if the benefits are received from a Canadian fund.

New Zealand also has a tax system for retirement benefits that is different to the tax system of South Africa. New Zealand taxes the fund on the growth in the retirement benefit and does not tax the retiree when the benefit is paid out. This is quite the opposite in South Africa, since the retirement fund is not taxed on the growth, but the retiree is taxed upon pay-out. South Africa and New Zealand also have different tax treatment relating to cross-border retirement benefits. South Africa taxes residents on local retirement benefits and not on foreign retirement benefits. New Zealand, on the other hand, does not tax residents on local retirement benefits, but on foreign retirement benefits, subject to double tax agreements. New Zealand does also not provide tax relief for contributions to funds, like South Africa provides tax deductions regarding fund contributions. For non-residents, the tax treatment also differs since South Africa looks at the country of services rendered as well as the location of the fund and New Zealand looks at the country where the fund is located.

Lastly, the United Kingdom and South Africa have more comparable tax systems, since neither country taxes the retirement fund on the growth in the fund. The tax treatment between the United Kingdom and South Africa also shows differences with regard to cross-border retirement benefits. The United Kingdom aims to tax worldwide retirement benefits and will provide tax relief to residents when double tax occurs. South Africa, however, provides a tax exemption to their residents on benefits received from foreign retirement funds for services rendered abroad. For non-residents, the United Kingdom aims for the country of residence to have the taxing right, but South Africa taxes non-residents based on the services rendered in South Africa and if the fund is located in South Africa.

None of the countries provide their residents with an exemption for retirement benefits from foreign funds as South Africa grants through section 10(1)(*gC*) of the *Income Tax Act*. This is relief provided by South Africa, which makes South Africa more lenient when it comes to cross-border retirement benefits for their residents. South Africa taxes non-residents when services were rendered in South Africa and when the fund is located in South Africa. Most countries will tax a non-resident when the funds were received from a fund located within that country, or will give the taxing right to the country of residence. South Africa has no provision that gives the country of residence taxing rights, except when such a rule is contained in a double tax agreement between South Africa and another country.

5.2 Conclusion of findings

The South African tax system has undergone many changes, especially when it comes to the cross-border retirement benefits. South Africa taxes residents on retirement benefits, but provides an exemption for cross-border benefits for services rendered abroad. Non-residents are taxed based on the location of the services rendered as well as the payment being made from a South African fund. This indicates that for retirement income, South Africa deviates from the residence based principle of taxation.

The tax treatment that South Africa has for residents and non-residents can be compared to suggested policies by the OECD and the UN. The OECD does not however have different policies for residents and non-residents and has the preferred view that the country of residence should have the taxing right, which indicates that South Africa's tax treatment is not entirely aligned with the view of the OECD. The UN, however, prefer that the source country should have the taxing right, with the country where the services are rendered and the country where the fund is located being acknowledged. South Africa's tax treatment is more in agreement with the UN's view.

When compared to other international countries, South Africa has a more lenient tax treatment for residents, giving them exemption on foreign retirement benefits, where other countries aim to tax their residents on the foreign retirement benefits earned. South Africa therefore does not tax residents on worldwide income for retirement benefits, which can lead to lost tax revenue. South Africa also has a different tax treatment for non-residents, taxing them on retirement benefits when the services were rendered within South Africa, and not solely based on whether the fund is located in South Africa. Other countries aim to only tax non-residents when a fund in that country pays the benefit or not to tax non-residents at all. All of these tax treatments are subject to specific double tax agreements between the different countries.

From the above it is clear that South Africa has a unique tax system when it comes to cross-border retirement benefits, where only certain elements of the tax treatment is comparable to international trends and practices. The main difference is that South Africa does not aim to allow the country of residence to have the sole taxing right over retirement benefits. South Africa provides relief to its residents regarding foreign retirement benefits. For non-residents, South Africa also specifically looks at whether the services were rendered in South Africa. Consequently, in South Africa the source of the retirement benefit plays a major role in the taxation thereof, and not necessarily the residency of the taxpayer, which is not in line with the residence-based tax system. The current tax position in South Africa is comparable to international trends, however not closely aligned to the OECD's preferred view, but rather to the UN's view.

With all the above taken into account, it would be suggested that South African tax legislation should be amended so that residents are taxed on their foreign retirement benefits. This will then be in line with the residence basis of taxation that South Africa adopted in 2001. It will furthermore align SA tax legislation with legislation in other countries that also apply the residence basis of taxation. This can also lead to more tax revenue for South Africa.

5.3 Areas for future study

Tax legislation undergoes constant changes and more studies can be done on the topic of how South Africa compares to international taxation trends. A more in depth study can be done on the role of double tax agreements and how it can change the current tax treatment as set out by legislation. The economic role of contributions to retirement funds and its impact on the tax treatment can also have potential for further study. Further areas of study can be the impact when a South African resident emigrates from South Africa, especially with the amended legislation effective 1 March 2021, which states that a member of a retirement fund can only withdraw the lump sum after three years of not being a tax resident.

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