



A critical analysis of the proposed exit tax on retirement funds in South Africa

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ABSTRACT

The South African retirement fund tax regime follows the exempt, exempt, taxed system. Under this system, retirement fund contributions and growth are exempt from tax. Tax will only be levied on the retirement fund benefit once the individual receives it. If an individual ceases to be a South African tax resident and becomes a tax resident of another country before retirement, South Africa may lose their taxing right on the retirement fund benefit. This is due to the provisions of certain double tax agreements, which grant the sole taxing right on retirement fund benefits to the residency country.

To address this, the National Treasury proposed to levy an exit tax on retirement fund benefits for individuals ceasing their South African tax residency. However, the proposal was withdrawn from the legislative cycle due to concerns raised on various issues, such as double taxation and the override of the double taxation agreement. The National Treasury noted that the proposal will be reworked to address these comments and reintroduced into a future legislative cycle. However, this has not yet occurred.

This mini-dissertation aimed to critically analyse the potential tax implications of the proposed introduction of an exit tax on retirement funds of emigrating individuals in South Africa and compare it to the laws of the United States of America (USA) and the international practices of the Organisation for Economic Co-operation and Development (OECD) to find possible recommendations for South Africa's anticipated legislation. The study made use of the qualitative research methodology. Specifically, doctrinal legal research, comparative legal research, and critical analysis were used.

In this study, it was found that the exit tax that is proposed in South Africa does not differ much from the exit tax that is in place in the USA. The primary difference is that the USA has concluded certain double tax agreements to allow for the taxation of former residency as if the double tax agreement was not entered into. On the other hand, the double tax agreements concluded by South Africa do not include such a saving clause. It was also found that the OECD's Model Tax Convention allocates the taxing right on retirement funds to the residence country. This is the view followed in most of the double tax agreements concluded by South Africa. The OECD, however, offers alternative provisions to the sole country of residence, which South Africa could consider.

Considering the above, for the proposed exit tax to work, South Africa would need to renegotiate the double tax agreements entered into with other countries to allow for exclusive or limited source taxation on retirement fund benefits.

Key terms: emigration, international practises, retirement fund benefits, retirement funds, tax implications, tax residency

LIST OF ABBREVIATIONS

For the purposes of this document, the following abbreviations apply:

CGT	Capital Gains Tax
IRS	Internal Revenue Service
Model Convention	Model Taxation Convention between Developed and Developing Countries
OECD	Organisation for Economic Co-operation and Development
SARS	South African Revenue Service
TAA	Tax Administration Act 28 of 2011
The Act	Income Tax Act 58 of 1962
UK	United Kingdom
UN	United Nations
USA	United States of America

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CHAPTER 1 INTRODUCTION

1.1 Background to the research area

South Africa has a residence-based tax system that stipulates that residents are taxed on their worldwide income. In contrast, non-tax residents are only taxed on income from a South African source (Louw, 2020). Over 40 000 South African taxpayers emigrated in the last five years and thus terminated their South African tax residency. The main reasons these individuals left were higher earning potential, more career growth, and a better quality of life (BussinesTech, 2023).

Section 9 of the Income Tax Act 58 of 1962 (“the Act”) deems lump sums, pensions, or an annuity paid or payable by a retirement fund to be a South African source if the retirement fund amount was received or accrued in respect of services rendered in the Republic. Effective 1 March 2021, an individual who emigrates may only access their retirement funds once the individual has been a tax resident of another country for an unbroken period of three years or longer. Prior to 1 March 2021, an individual could access their retirement funds once they emigrated from South Africa; thus, they could access their retirement funds before their actual retirement date and could move their retirement funds offshore (Baines, 2021). Due to double tax agreements in place between South Africa and other countries, when an individual becomes a tax resident of the other country, their retirement funds may be taxed in their new country of tax residency. Thus, there is a risk that South Africa could forfeit their taxing right (National Treasury, 2021a:12).

Most tax treaties are drafted based on the provisions of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, which stipulates that retirement funds are taxed in the country of the individual's tax residency. No consideration is given to the source of the retirement funds or the country in which the services were rendered, which led to the retirement funds being received or accrued (Howell, 2022:9). Many of South Africa's double tax agreements concluded with other countries are in line with Article 18 of the OECD's Model Tax Convention (Botha & du Toit, 2021:7).

To address the above issues, the National Treasury (2021a:12) proposed an amendment to the current tax legislation to ensure that the retirement funds of an individual who gives up their South African tax residency are taxed in South Africa. The value of the emigrating individual's retirement benefit would be determined the day prior to the date of their residency being ceased, regardless of the individual's intention of their retirement funds. The emigrating individual's retirement funds are proposed to be taxed at the same rates as would normally be applicable to a retirement benefit or withdrawal benefit. The emigrating individual will be deemed to have withdrawn their retirement

funds on the day prior to the day that they cease their tax residency. The retirement funds will be included in their assets and will be subjected to the tax at the withdrawal tax tables. The tax payment will, however, be deferred until the individual receives the retirement benefit from the retirement fund. At this stage, the tax will be recalculated based on the individual's intention. If the taxpayer withdraws the retirement funds prior to retirement, then the tax will be calculated based on the withdrawal benefits. If the individual retains the retirement funds until death or retirement, then the retirement funds will be taxed based on the lump sum or annuity tax tables. In both cases, a tax credit will be allowed for the tax calculated on the day the individual ceases to be a resident (National Treasury, 2021a:12).

The above would have been achieved by amending the wording to section 9H(2) of the Act to clarify that the retirement fund benefits will not be subject to the deemed disposal when an individual ceases their tax residency. Additionally, the insertion of the proposed section 9HC would indicate that the retirement funds of an individual ceasing their South African tax residency will be subject to tax in South Africa, irrespective of whether the individual withdraws or retains their South African source retirement fund benefit when ceasing to be a tax resident (Cliffe Dekker Hofmeyr, 2021).

Introducing an exit tax on retirement funds was proposed to ensure that the fiscus is not being prejudiced (BussinessTech, 2022). The tax incentive of retirement funds is that the payment of tax on retirement funds is delayed to when the benefits will accrue to the individual (Van Rensburg, 2014:5). Howell (2022:10) explains that, currently, an individual who ceases their South African tax residency is not taxed in South Africa on their retirement funds due to the tax treaties in place, which is unfair to individuals that remained South African tax residents as they will be taxed on their retirement fund benefits. Additionally, an emigrating individual receives a tax benefit in the form of deductions on contributions to retirement funds during the years of assessment in which they were South African tax residents with no tax being levied on the pay out of their retirement funds benefits, which is inequitable.

The proposal to levy an exit tax on retirement funds of individuals ceasing their South African tax residency would go against Article 18 of the OECD's Model Tax Convention and the double tax agreements between South Africa and other countries. This is due to South Africa levying tax on the retirement funds as the source country, and not as the country of residence. Additionally, it would create a tax treaty override as South Africa would be introducing legislation that contravenes the arrangements of the double tax agreements concluded with other countries, which could affect South Africa's tax treaty partners. This would also affect the emigrating individual as they may be subject to double taxation, as they might be taxed in South Africa, based

on the proposed change to legislation, as well as the new country of residency, because retirement fund benefits will be taxed in the individual's country of residency (Botha & du Toit, 2021:7).

Exit taxes are imposed on taxpayers who terminate their South African tax residency. The concept of exit taxes was introduced as part of the provisions of Capital Gains Tax (CGT), which was introduced on 1 October 2001 (Botha, 2018:6). Section 9H(2) of the Act deems an individual that ceases to be a South African tax resident to have disposed of certain of their assets at its market value on the day before they cease to be South African tax residents to determine a CGT charge. The individual is further deemed to have reacquired the assets on the day they cease to be a South African tax resident at the market value determined on the day before they ceased their tax residency. The Financial Emigration (2023) states that this is due to the South African Revenue Service (SARS) viewing the resident individual as disposing of their assets to their non-resident self. De Broe (2002:34) further explains that an exit tax is in place to recoup any allowances or deductions that the taxpayer received and tax the taxpayer on any capital gains or losses that arose during their residency.

The rationale behind imposing an exit tax is to ensure that if a taxpayer ceases their tax residency, South Africa will not lose their taxing right (Ger, 2012). SARS (2020:119) explains that the imposition of an exit tax is to protect the South African tax base and, in doing so, also protect the general public's interest. If exit taxes were not imposed on taxpayers ceasing their tax residency, SARS would experience difficulties collecting the taxes once the asset has been disposed of. Exit taxes are not unique to South Africa; many open and democratic countries use them.

1.2 Literature review of the topic/research area

According to Bryman (2016:90), a literature review is conducted to determine what is already known regarding a research topic and for that knowledge to serve as a foundation for research. McKercher (2008:6) states that a literature review should be conducted by reading broadly in the research area under review before narrowing it down to specific aspects that form the research objectives. Therefore, the literature review will start by looking at the general principles of taxation on retirement funds before being narrowed down to the cross-border treatment of retirement fund benefits and the imposition of exit taxes.

While performing a literature review on taxation on retirement funds in South Africa, studies were carried out on various topics, including the increase in the maximum deduction for retirement contributions, the impact of financial literacy on retirement savings, as well as the taxation of cross-border retirement funds and foreign source retirement funds.

Le Roux (2017:6) conducted a study in which the financial and tax literacy levels of South Africans regarding financial independence during retirement were investigated. The study explored whether individuals gain a better understanding of financial and tax concepts, if this leads to increased willingness to save for retirement, and whether financial independence during retirement can be enhanced through improved financial and tax literacy. In this study, it is mentioned that various tax incentives are in place to encourage individuals to save for retirement, but if individuals do not understand the principles, they are unlikely to benefit from these tax incentives. Based on the study performed, Le Roux (2017:6) concluded that increased financial and tax literacy could increase saving and financial independence during retirement.

A related study by Moolman (2015:3) aimed to determine the factors that stopped South Africans from saving for retirement or saving more for retirement, as well as to assess their level of awareness regarding tax incentives on retirement funds and whether the participants would start saving or save more with the new tax incentives. The tax incentives mentioned above relate to harmonising the tax treatment of the various retirement funds and increasing the percentage of deduction available on contributions. Moolman (2015:56) concluded that the majority of South Africans are unaware of proposed changes to the taxation of retirement funds. More needs to be done to educate South Africans on changes to tax incentives regarding retirement funds. Moolman (2015:56) further states that most individuals surveyed would increase their retirement fund savings if the proposed increased tax incentives were introduced.

Du Plessis (2015:2) conducted a study on the Taxation Laws Amendment Act 31 of 2013, which effectively adjusted the maximum amount allowed as a deduction for contributions made to retirement funds to R350 000. This study compared the South African tax consequences on retirement funds with specific reference to the capping of retirement contributions to the tax consequences in developed countries such as Australia, Denmark, and Ireland. This comparison was done to determine if South Africa's tax treatment of retirement funds is in line with those of these developed countries. It was concluded that the increase in the contribution cap introduced in South Africa brought the contribution cap more in line with the developed countries under review.

Mans (2021:2) conducted a study in which the South African tax treatment of cross-border retirement fund payments was compared to international policies and practices. This research aims to study the development of tax laws on retirement funds since the tax system changed from source-based to residency-based. The study examined the South African tax treatment of cross-border retirement funds compared to the OECD's double tax agreement model policies. Therefore, retirement fund benefits obtained from a foreign-sourced retirement fund are exempt

from tax in South Africa. If a South African tax resident worked abroad and contributed to a South African retirement fund, the benefits derived while working abroad would not be exempt and would be taxed in South Africa.

Furthermore, South Africa provides relief to individuals who contributed to a foreign fund by exempting the benefits, which none of the countries under review did. Regarding non-residents, South Africa taxes retirement fund benefits if the services were performed in South Africa and the fund is located there. In contrast, the countries under review tax non-residents based on whether the funds are from a local retirement fund or grant taxing rights to the country of residence — an approach South Africa does not follow unless a double tax agreement between South Africa and the other country specifies otherwise.

Botha (2018:10) conducted a study to consider whether the current South African exit tax provisions are proportional to the purpose of exit tax and, if it is not proportional, what measures can be taken to restore the balance between the manner the exit tax is levied and the purpose of the exit tax. This study compared the South African exit tax to the European Union exit tax and OCED publications. The study found that the exit tax in South Africa is levied on capital gains that has not been realised and that the exit tax is required to be paid immediately upon emigration. It was agreed that the imposition of an exit tax in South Africa is justifiable, but the method of collection is not justified due to the cash flow problem it creates. Suggestions based on approaches followed by other countries were provided to overcome the cash flow challenge, including spreading the exit tax payment over several instalments and allowing the taxpayer the option to defer the exit tax charge until the asset is actually disposed of.

Moser's (2019:2) study aimed to determine whether individuals are protected by double tax treaties against double taxation in the case of an exit tax being charged when a person emigrates from South Africa. It was concluded that South Africans who emigrate are not protected by tax treaties against double taxation. Instead, they will rely on the domestic tax laws of their new country of tax residence, which should consider the exit tax paid on the asset when the individual emigrated on the actual disposal of the asset.

The research papers considered above indicate that research was conducted in general on this study's topic; however, there is a gap in the literature on the proposed exit taxes on retirement funds. Therefore, this study aims to fill this gap in the literature.

1.3 Motivation of topic actuality

As discussed above, the National Treasury (2021a:12) proposed introducing an exit tax on retirement funds of emigrating individuals to ensure that their retirement fund benefits are taxed in South Africa. Currently, the exit tax is not yet effective, but it is only proposed. As such, this study could assist in identifying potential challenges with the proposal by considering the effect the proposal would have on the taxation of the retirement funds of emigrating individuals. As previously noted, there is a gap in the literature regarding the proposed exit taxes on retirement funds in South Africa, which this study aims to fill.

Howell (2022:11) highlighted some concerns raised by tax practitioners on the proposed legislation. The exit tax on retirement funds will be levied on the individual the day before they cease to be a tax resident. The individual may only access their retirement fund benefits after three years of being a non-resident for South African tax purposes. During this three-year period, interest will accumulate on the outstanding tax charged. When the individual leaves their retirement fund after this period, the tax will be calculated using the prevailing tax rates on the total retirement interest on the date they exit the retirement fund. This tax calculated will be reduced by the tax calculated on the day before the individual ceases their tax residency. As a result, the following questions arise: What will happen to the interest accrued on the exit tax? Is it reasonable and constitutional to levy interest on a tax that is not due, as it is only due once the individual exits their retirement fund? Another concern noted by Howell (2022:12) is that only one-third of the total retirement interest can be taken as a lump sum, while the remaining two-thirds will be paid out in monthly annuities. However, the exit tax will be calculated on the total retirement fund interest as of the day before the individual ceases to be a tax resident.

Botha and du Toit (2021:10) further explain that introducing the exit tax on retirement funds will lead to double taxation of retirement funds for individuals who emigrate. This is because no tax relief will be available to taxpayers as the proposed exit tax goes against the provisions of the tax treaty agreements in place. To avoid the double taxation on retirement funds, the individual's new country of residence would need to give a tax credit for the exit tax imposed by South Africa, which is not likely to happen. The proposed exit tax on retirement funds in its current form will not only contravene the double tax agreements but will also contravene section 108(1) of the Act, which provides that double tax agreements are part of the domestic law.

In a survey conducted, the majority of South Africans who have ceased their tax residency still have an interest in South African retirement funds and value the South African retirement industry offerings. However, unjust tax treatments could lead them to consider taking their investment elsewhere. Therefore, the proposed exit tax on retirement funds could lead these individuals to

leave the South African tax net (Botha & du Toit, 2021:5). Howell (2022:12) questions whether the proposed exit tax on retirement funds is reasonable and fair as taxpayers are protected from unlawful, unreasonable, and procedurally unfair administrative decisions by the Promotion of Administrative Justice Act 3 of 2000. The proposed exit tax on retirement funds was withdrawn due to the tax treaty override that would occur if the exit tax was brought into legislation. The proposed exit tax will be considered again during subsequent legislative cycles to address the complexities raised (National Treasury, 2021b:21).

Based on the above concerns raised regarding the proposed exit tax, this creates an opportunity to analyse the proposed legislation, identify the potential challenges, and make recommendations before new proposals for the legislation are finalised. To gain a better understanding of the workings of an exit tax on retirement funds, the exit tax on retirement funds in the United States of America (USA) was considered, as well as the international guidelines set out by the OECD. The USA imposes an exit tax on retirement funds of individuals ceasing to be USA tax residents (Diosdi, 2022), which makes it comparable to the proposed South African legislation. The OECD (2017a:16) guidelines also set out international guidelines regarding the taxation of retirement funds of emigrating individuals.

Therefore, the analysis of the proposed legislation in South Africa can be compared to that in the USA and to the guidelines from the OECD. This comparison will illustrate how the South African proposals align with these guidelines and provide an opportunity to make recommendations for improvements to the draft legislation.

1.4 Problem statement and research question

1.4.1 Problem statement

In the 2021 Taxation Laws Amendment Bill, a proposal was made to amend the current tax legislation to ensure that interests in retirement funds of individuals who are emigrating are taxed in South Africa, as would be the case for non-emigrating individuals. This ensures that South Africa does not lose their taxing rights due to tax treaties between South Africa and the individual's new country of residence. However, this proposal to introduce an exit tax on retirement funds for emigrating individuals poses some concerns and challenges, as identified above. Therefore, the proposal was withdrawn by the National Treasury to make improvements before it is reintroduced.

1.4.2 Research question

What is the potential taxation treatment of the exit tax on the retirement funds of emigrating individuals in South Africa, and what recommendations can be made towards anticipated legislation based on good practices followed by the USA and the OECD?

1.5 Research objectives

1.5.1 Main objective

The main objective of this study is to critically analyse the potential tax treatment of the proposed introduction of an exit tax on retirement funds of emigrating individuals in South Africa, as proposed by the 2021 Draft Taxation Laws Amendment Bill ("2021 Draft TLAB"). This will enable the researcher to compare it to the laws of the USA and the international practices of the OECD to find possible recommendations for South Africa's anticipated legislation.

1.5.2 Secondary objectives

To achieve the main objective, the following secondary objectives were formulated:

- i. To critically analyse the current tax implications on retirement funds of individuals who are emigrating and the potential tax implications of the proposal to introduce an exit tax to ensure that retirement benefits are taxed in South Africa when an individual emigrates. These two approaches will be compared (Theoretical Objective) (Chapter 2).
- ii. To analyse the tax implications on retirement benefits of emigrating individuals in the USA and compare it with the potential tax implications of the proposed introduction of an exit tax on retirement fund benefits in South Africa, as well as with international practises such as the OECD guidelines. This will be done to suggest improvements to the South African proposal to levy an exit tax on retirement funds (Theoretical Objective) (Chapter 3).

1.6 Research methodology

1.6.1 Research paradigms

1.6.1.1 Research paradigm, ontological, and epistemological assumptions

A paradigm is a set of assumptions or beliefs about fundamental aspects of reality that give rise to a particular worldview. It addresses fundamental assumptions taken on faith, such as beliefs about the nature of reality (ontology), the relationship between the knower and the known (epistemology), and assumptions about methodologies (Creswell *et al.*, 2016:52). According to

McKercher (2008:6) there are traditionally two core research philosophical paradigms. These paradigms or organising frameworks that guide researchers are commonly referred to as positivism and interpretivism.

Researchers who want to explain social reality objectively tend to adopt positivism. According to this paradigm, the explanations are supported by actual data and tried-and-true theories, and the researcher is seen as being disassociated from the subjects being studied. The information generated by a positivist methodology, in other words, is founded on deductive reasoning, in which the researcher follows a methodical and exact process that results in the identification of causal links, logical conclusions, and the formulation of forecasts with varying degrees of confidence. The realist foundational ontology that underpins positivism holds that the world exists regardless of our understanding of it (McKercher, 2008:7).

Neuman (2003:76) describes the interpretive approach as researchers or readers bringing their own subjective experience to the text. The reader or researcher tries to understand the viewpoint of the text before delving into the smaller parts that make up the whole point. Neuman continues by saying that true meaning is not often simple but can only be achieved by a thorough study of the text, considering all the connections among its parts. According to Creswell (2007:21), a researcher's objective is to understand the meanings people have about the world. He adds that qualitative research goes together with the interpretivist paradigm. Pham (2018:3) states that the interpretivist paradigm is used not only to describe a phenomenon, but also to understand it; therefore, this research study was conducted using the interpretivist paradigm as it will attempt to obtain more information on the tax treatment of retirement funds of individuals that cease to be South African tax residents.

As stated by McKercher (2008:8), legal research can be seen as a paradigm of its own. Steven *et al.*, (2015:15) explain that legal research can be seen as a process of identifying and collecting legal information that will be used to support legal decision-making. Steven *et al.*, (2015:15) explain that it starts with studying the facts of the problem and ends with communicating the investigation results. Chynoweth (2008:672) describes legal rules as being normative in character and dictating how people should behave. Legal rules do not explain, predict, or understand human behaviour. The legal rule's function is to prescribe it.

According to Tiwary (2019:5), there are two types of legal research, namely, doctrinal and non-doctrinal. Chynoweth (2008:672) defines doctrinal research as being concerned with the formulation of legal "doctrines" through the analysis of legal rules. Chynoweth further states that

a complete statement of law can only be given after applying the legal rules to the facts and circumstances under review. Coetsee and Buys (2018:75) describe doctrinal legal research as a description of the current law, which becomes an interpretation of the law once professionals and academics provide an opinion of the laws. According to Kharel (2018:5), doctrinal legal research is an analytical study of legislation, case law, and other authoritative material as a whole or only related to a specific matter. He adds that doctrinal legal research can be used to confirm existing knowledge on a legal issue. Conversely, Ali *et al.*, (2017:494) define non-doctrinal research as legal research that uses methods from other disciplines to generate empirical data to answer research questions. McKercher (2008:19) contrasts doctrinal and non-doctrinal research by stating that non-doctrinal research is research about law, not research in law, as with doctrinal research.

Mercescu (2020:1) defines comparative legal research “as the act of comparing two or more legal cultures.” Mousourakis (2019:1) states that the purpose of comparing legal systems is to obtain knowledge which may be used in theoretical and practical pursuits. Mousourakis (2019:5) also states that comparative legal research can be used to gain a better understanding of the law. Smits (2006:60-61) concurs that comparative legal research can be used to gain a better understanding of the law in one’s own country by contrasting the laws of other countries and the wider net of information it provides. Hey and Mak (2009:1) state that legal doctrinal research includes comparative legal research, which compares how laws have changed over time (internal comparison) and compares laws of different countries (external comparison). Therefore, comparative legal research will be utilised in this research study, as the tax legislation of other countries will be compared to South Africa’s tax legislation. This will be done to compare the tax treatment on retirement funds of emigrating individuals of another country to the proposed tax treatment of emigrating individuals in South Africa.

1.6.2 Research methodologies

Nieuwenhuis (2014) describes methodology as the bridge that unites our view on ontology and epistemology (philosophical standpoint) and perspective and tool (method) with each other.

Denzin and Lincoln (2011:3) define qualitative research as a “situated activity that locates the observer in the world.” They add that in qualitative research, the researcher aims to obtain an interpretation of the phenomena by trying to understand the meanings that individuals attribute to those phenomena. On the other hand, Maree (2016:162) defines quantitative research as a process that is both systematic and objective in its workings. Quantitative research uses numerical data selected from only a sub-group of a whole population and uses that data to come

up with a conclusion regarding the whole population. According to Bryman (2016:401), in quantitative research, the researcher is in the driving seat of the research and uninvolved with the participants. In contrast, in qualitative research, the participants' views provide the direction of the research, and the researcher seeks close involvement so that the researcher can truly observe and understand the world as seen by the participant.

McKercher (2008:15) posits that the qualitative research methodology aims to find answers to questions and does not aim to prove or disprove a hypothesis. Therefore, the qualitative research methodology will be used in this research study as the purpose of the study is to gain a thorough understanding of the tax consequences of emigrating individuals' retirement funds in South Africa, the USA, and international practices such as the OECD's guidelines. This answers the research question: What is the potential taxation treatment of the exit tax on the retirement funds of emigrating individuals in South Africa, and what recommendations can be made towards anticipated legislation based on good practices followed by the USA and the OECD?

1.6.3 The following methodological assumptions were made for this research study

- i. Legislation of the countries under review is comparable to each other.
- ii. The tax authorities of all the countries under review operate in a fair and reasonable manner, and the taxes they levy are also fair and reasonable.
- iii. There will be consistency in policy across the taxation legislation.

This research study started by broadly gaining an understanding of how retirement funds are taxed in South Africa. Specific focus was placed on the current tax treatment of retirement funds of individuals who are giving up their South African tax residency. The tax treatment on retirement funds of individuals giving up their South African tax residency was compared to the tax treatment of retirement funds of individuals who continue to be South African tax residents. This was done by making use of doctrinal legal research and critical analysis. Coetsee and Buys (2018:75) describe doctrinal legal research as a description and interpretation of the current law. Hassan (2023) defines critical analysis as the act of studying literature in a systematic, objective, and analytical way. Critical analysis makes understanding the literature easier by breaking it down into smaller and more manageable parts. Therefore, to achieve the above-stated objective, the Income Tax Act 58 of 1962 was studied. This study also focused on the proposal to introduce an exit tax on retirement funds of individuals who cease to be South African tax residents. In addition, the draft explanatory memorandum on the Draft Taxation Laws Amendment Bill of 2021 and various news articles were studied to gain a better understanding of the proposal.

Doctrinal legal research and critical analysis were used again, but this time, they looked at the tax legislation of countries that impose an exit tax on retirement funds of individuals ceasing their tax residents. The country selected is the USA. A critical analysis was also performed on the conditions of ceasing to be a tax resident of the country, with specific reference to retirement funds.

As explained by Smits (2006:60-61), comparative legal research can be used to gain a better understanding of the laws of one's own country, as well as to compare legal systems and gain more information as a result. Comparative legal research was thus used to identify similarities and differences in the taxation laws surrounding retirement funds in the USA and South Africa. This was done to identify aspects of the USA's approach to imposing an exit tax on retirement funds that worked well and that South Africa can adopt. It has also identified contentious issues in the approach followed by the USA that can be avoided in South Africa. These aspects were identified by analysing the legislation of the USA and any guidance document provided by their respective governments on exit tax on retirement funds.

1.6.4 Methodological assumptions

The USA has been a member of the OECD since 1961 (OECD, 2020), which signifies that they have well-established tax policies, which include tax policies regarding the taxation of retirement funds, with a specific focus on individuals who are emigrating. The United Nations (UN) Statistics Division (2022) classifies the USA as a developed country, whereas South Africa is classified as a developing country. Comparing South Africa to the USA, a developed country could help South Africa improve its tax legislation regarding the taxation of retirement funds of individuals ceasing their tax residency.

When an individual ceases to be a USA resident, their retirement benefits are deemed to be disposed of and will be subjected to expatriation tax (Diosdi, 2022). Expatriation tax is a tax levied on USA citizens and long-term residents who have denounced their USA residency status for tax purposes (IRS, 2023). According to Perceptions (2020), approximately 40 million people emigrated out of the USA by the end of 2019, an increase from the total in 2005, which was 29.3 million people. This indicates that emigration is also relevant for the USA to be comparable to South Africa.

1.6.5 Literature study

This study took the form of a literature study. eNotes (2010) defines a literature study as a study in which selected texts are analysed and a study is done on them. The selected literature could

be compared against other literature. Furthermore, in a literature study, the researchers' thoughts on the text, as well as the thoughts of others, are documented. The literature that was used in this study is secondary data sources, which are publicly available.

The following sources were used:

- South African Income Tax legislation
- United States of America Tax Legislation
- Theses and dissertations
- Newspaper and magazine articles (including online sources)
- Journal articles

1.6.5.1 Data collection and analysis

This study took the form of a document analysis. Bowen (2009:1) defines document analysis as reviewing or evaluating documents. Documents used in this research method can vary from Acts to previous studies. The data collection technique followed in this study analysed South African legislation, with specific reference to the Act. An analysis of the USA tax legislation was also conducted. For the first secondary objective, the Act was studied, and guidance documents were provided by these governments. For the final secondary objective, the USA tax legislation was studied.

1.7 Ethical considerations

The ethical risk is minimal, as this is a desktop study that will involve analysing secondary data available in the public domain. Therefore, there was no contact with humans. Ethical clearance was obtained from the North-West University's ethics committee.

1.8 Chapter overview

1.8.1.1 Chapter 1: Introduction

Chapter one provides the study's introduction, which consists of the background to the research area, a literature review of the research area, and the motivation of topic actuality. Chapter one also includes the problem statement, research question, and primary and secondary objectives. Furthermore, chapter one also highlights the research design and the research methodology of the study. Research design entails the ontological and epistemological assumptions made for this research study.

1.8.1.2 Chapter 2: South African tax treatment of retirement fund benefits of emigrating individuals

This chapter critically analyses the current taxation implications of retirement funds for both residents and individuals planning to or have ceased their tax residency. The chapter also critically analyses the potential tax implications of the proposal to amend the legislation to introduce an exit tax to ensure that retirement benefits are taxed in South Africa when an individual ceases their tax residency. This is then compared to one another. This chapter addresses the secondary objective identified in section 1.5.2(i).

1.8.1.3 Chapter 3: USA and OECD guidance tax treatment of retirement fund benefits of emigrating individuals

This chapter critically analyses how the USA taxes retirement fund benefits individuals who have ceased their USA residency. It also critically analyses the differences and similarities of the taxation of retirement funds in South Africa and the USA to determine what factors South Africa should consider when amending legislation imposing an exit tax on retirement funds. It further analyses the international guidelines set out by the OECD and compares them to the South African proposal to levy an exit tax on retirement funds of emigrating individuals. The third chapter addresses the secondary objective identified in section 1.5.2(ii).

1.8.1.4 Chapter 4: Summary and conclusion

The final chapter presents the findings and conclusions of Chapters two and three. A recommendation of the policy aspects that South Africa should consider when amending the legislation to impose the exit tax on retirement funds is provided in this chapter. The final chapter also considers whether the research objectives have been met and whether the research questions have been answered.

CHAPTER 2 SOUTH AFRICAN TAX TREATMENT OF RETIREMENT FUND BENEFITS OF EMIGRATING INDIVIDUALS

2.1 Introduction

Due to the economic uncertainty that South Africa is currently facing, emigration has become the new norm. One of the key considerations an emigrating individual needs to make before emigrating is what will happen to their retirement fund benefits (Tshabalala, 2020). Wellburn (2022) notes another consideration that individuals emigrating would need to make is to consider the tax implications on retirement fund interests in South Africa. Howell (2022:9) adds that over the past few years, there have been a few changes to the tax legislation regarding the taxation of retirement fund interests of emigrating individuals who cease to be South African tax residents.

One of the secondary objectives of this study is to critically analyse the current tax implications on retirement funds of individuals who are emigrating and to critically analyse the potential tax implications of the proposal to introduce an exit tax to ensure that retirement benefits are taxed in South Africa when an individual emigrates. This chapter, therefore, addresses the secondary research objective as identified in section 1.5.2(i). Botha and Du Toit (2021:4) note that many individuals who ceased their South African tax residency still have retirement fund savings in South Africa. Stricter tax laws on retirement funds would negatively affect these individuals, leading them to change their retirement planning.

This chapter focuses on the taxation of retirement funds in South Africa for individuals who are emigrating and ceasing their South African tax residency. This includes the study of draft amendments to tax law and the respective explanatory memoranda. The purpose of this chapter is to determine the tax implications of the proposed exit tax on retirement funds of individuals ceasing their South African tax residency and to compare it to the current tax implications.

2.2 Brief overview of the taxation of retirement funds in South Africa

“The objectives of a well-designed pension system are poverty reduction in old age and income smoothing throughout an individual’s lifetime” (Stewart *et al.*, 2019:3). These objectives are underpinned by the fact that the government would like individuals to save for retirement on their own, and to ensure that the government does not need to look after them, financially after retirement, through old age grants. Van Rensburg (2014:5) explains that the tax incentive used to encourage saving for retirement is that the payment of tax on retirement funds is delayed to when the benefits accrue to the individual.

Three types of retirement funds exist in South Africa, namely, pension funds, provident funds, and retirement annuity funds. Although the three types of retirement funds are clearly distinguished from each other, all three are governed by the Pension Funds Act 24 of 1956. Furthermore, all retirement funds must be approved by the Commissioner of SARS (Van Rensburg, 2014:15). The National Treasury has tried to eliminate the differences between these funds to harmonise the tax treatment (Bredenkamp, 2021:1). For the purposes of this study, the term retirement fund will be used as a collective term for all three of these funds.

The South African retirement fund tax regime follows the exempt, exempt, taxed (EET) system. The EET system can be explained as follows: The first E refers to the contributions to retirement funds that are exempt from tax via a tax deduction; the second E refers to the exemption of the investment income earned while the individual is a member of the retirement fund; and the T refers to the taxation of the retirement fund benefit, which is taxed when the individual retires, dies, or withdraws the benefit (Nhabinde & Schoeman, 2008:3).

Section 11F of the Act allows for a deduction of contributions to retirement funds. Schneider (2016:1) explains that the deduction for contributions to retirement funds is subjected to a limit. Schneider (2016:1) further clarifies that contributions more than the limit are allowed to be carried forward to the next year of assessment to be considered for a deduction. Any contributions made that were not allowed as a deduction will not be subject to tax when the benefits are paid out on withdrawal or retirement. SARS (2024a:98) notes that section 11F of the Act was enacted on 1 March 2016. The deduction allowed under this section is the lesser of:

- “R350 000; or
- 27.5% of the greater of –
 - Remuneration (excluding retirement lump sum benefits, withdrawal lump sum benefits and severance benefits); or
 - taxable income (including passive income and taxable capital gains) but excluding retirement lump sum benefits, withdrawal lump sum benefits and severance benefits and before any section 11F and section 18A deduction; or
- the taxable income (excluding any taxable capital gain and retirement lump sum benefits, withdrawal lump sum benefits and severance benefits) and before any section 11F and section 18A deduction.”

As mentioned earlier, growth on the retirement fund investment is not taxed. Currently, there are four main ways of accessing retirement fund benefits, namely, withdrawal, retirement, death, or emigration, each of which has its own tax treatment. Withdrawals are triggered by loss of employment, whether due to resignation, dismissal or retrenchment. An individual can choose to

withdraw their retirement fund benefit, which will be subject to tax, using the withdrawal lump sum benefit tax table, under which the first R27 500 of the withdrawal is not subject to tax (Sanlam, 2019:3; SARS, 2024b). Transfers between retirement funds are exempt from tax; this includes transfers to preservation funds or retirement annuity funds (Van Rensburg, 2014:5). This typically happens when an employee leaves their employment and transfers their retirement savings to a preservation fund or retirement annuity fund. This can also be done when an individual reaches retirement age but does not retire and, as such, transfers their retirement funds to a retirement annuity fund or preservation fund.

Furthermore, under the rules of the Two-Pot Retirement System, which came into effect on 1 September 2024, an individual can also access a portion of their retirement savings before retirement. One of the pots or components under this system is the savings pot, from which an individual can access their retirement savings. This pot constitutes 10% of the individual's retirement savings up to 31 August 2024, capped at R30 000 and one-third of any contributions made after 1 September 2024. An individual may make a single withdrawal each year from this pot, limited to a minimum withdrawal of R2 000 before any transaction costs. This withdrawal will be taxed at the individual's marginal tax rate. Under the Two-Pot Retirement System, individuals will no longer be able to access their retirement savings upon loss of employment (Stiglingh *et al.*, 2024:295-296).

When an individual retires, they are allowed to take a maximum of one-third of their retirement interest as a lump sum; the remaining two-thirds will be paid out as an annuity. However, if the individual's total retirement interest does not exceed R247 500, then the individual may take the full amount as a lump sum. Any contribution made to the retirement fund that was not previously allowed for a deduction will now be set off against the lump sum benefit. The lump sum benefit is taxed using the severance benefits and retirement fund lump sum benefits tax table, under which the first R550 000 of the lump sum will not be taxed; this represents a once-off exemption. On the other hand, annuities will be taxed during the year of assessment they were received using the normal tax rates applicable to natural persons (SARS, 2024b).

If an individual dies before their retirement date, their retirement benefits are paid over to the financial dependents or nominees. Their financial dependents or nominees can choose whether to take the retirement benefit, which will be taxed in the hands of the dependent or nominee using the severance benefits and retirement fund lump sum benefits tax table. The dependents or nominees may use the retirement benefits to purchase annuities; there will be no tax implication on the purchase of the annuities, and the annuity income will be subject to tax in the hands of the

dependent or nominee using the standard tax table applicable to natural persons. The financial dependents or nominees may elect a combination of the above options (Jordaan, 2021).

The tax on withdrawal benefits, severance benefits, and retirement fund lump sum benefits (lump sums) are calculated using the cumulative or aggregation principle. The cumulative principal entails adding to the current lump sum and any previous lump sum after specific dates together when calculating the tax due on the current lump sum; as such, the tax is calculated on the cumulative amount of lump sums in accordance with the respective tax table. The tax payable on the previous lump sums received is deducted from the tax payable on the cumulative amount to determine the tax payable on the current lump sum (SARS, 2023:66).

The South African retirement tax system is set up to encourage individuals to save for retirement while ensuring that the fiscus of the country is not harmed. This is achieved by various mechanisms, such as providing a tax deduction for contributions to retirement funds, the non-taxation of the growth in retirement funds, and making use of more lenient tax tables when the retirement funds are received. Additionally, early access to retirement fund benefits is discouraged by using a more punitive tax table, which aims at discouraging early access to retirement fund benefits. In ensuring that the fiscus is not harmed, an individual's retirement funds are only subject to tax when the individual receives the benefit. The final way of accessing retirement funds is when an individual emigrates from South Africa. The tax implications thereof will be explored in detail in the remainder of this chapter.

2.3 South African tax residency

South Africa has a residency-based tax system, which determines that tax residents are taxed on their worldwide income, whereas non-tax residents are only taxed on South African source income (Louw, 2020). The taxation of an individual who emigrates from South Africa is dependent on whether the individual is deemed a resident or non-resident of South Africa for taxation purposes. Therefore, the 'South African tax residency' concept is important to this study and will be explored further.

The term resident is defined in section 1 of the Act in the instance of an individual as any natural person who is ordinarily resident in the Republic or physically present in the Republic. In essence, the definition states that there is a two-part test to determine residency for natural persons, the first is the ordinarily resident test and the second is a physical presence test. The term 'ordinarily resident' is not defined in the act; therefore, court cases need to be considered to better understand the term. The approach followed by the courts in the *Cohen v CIR* (13 SATC 362) case and confirmed by *CIR v Kuttel* (54 SATC 298) case is that an individual is ordinarily resident

in the country in which they reside apart from their temporary absences, which is the country they naturally and as a matter of course return from their wanderings (SARS, 2018a:2). The physical presence test should only be considered if the individual does not meet the ordinarily resident test.

Section 1 of the Act's definition of a resident states that physical presence is achieved if the individual was present in the Republic for more than 91 days in aggregate during the year of assessment under consideration, as well as during each of the previous five years of assessment. In addition, the individual should be physically present in the Republic for more than 915 days in those previous five years of assessment. However, if the individual deemed to be a resident by this definition is out of the Republic for at least 330 full consecutive days, then they will be deemed to be a non-resident on the day the individual ceases to be physically present in the Republic. The definition of resident explicitly deems an individual to be a non-resident if they are exclusively a resident of another country in terms of a double tax agreement concluded between South Africa and the other country.

Instances may arise where an individual may be a resident of South Africa in terms of the Act, but also be a resident of another country based on their domestic tax laws. The double tax agreement between South Africa and the other country, if there is one, will determine via tie-breaker clauses to which country the individual is exclusively a resident. If the double tax agreement deems an individual to be exclusively a resident of the other country, then they will not be a resident of South Africa in terms of the Act (SARS, 2018b:8). If there is no double tax agreement between South Africa and the other country, the individual's residency will be determined with reference to domestic legislation only (Mac Hutchon, 2020:24).

Based on the above, it can be deduced that determining an individual's tax residency is of utmost importance as the tax implications differ between tax residents and non-residents. While the term resident is defined in the Act, the first test to consider being ordinarily resident is subjective. The individual's particular facts and circumstances must be considered at length to determine if an individual is considered a resident. Only if the ordinarily resident test fails should the physical presence in the Republic of the individual be considered. It is also important to consider if the individual is deemed to be exclusively a resident of another country in terms of applying a double tax agreement.

2.4 Ceasing to be a South African tax resident

There are two ways for an individual to emigrate from South Africa, namely, becoming a non-resident for tax purposes and financial emigration, commonly referred to as emigration for

exchange control purposes. Becoming a non-resident for tax purposes in South Africa will be achieved by no longer meeting the resident definition requirements as contained in the Act. It is important to note that becoming a non-resident for tax purposes does not automatically mean the individual has financially emigrated. On the other hand, financial emigration is achieved by applying to the South African Reserve Bank via an Authorised Dealer, such as the individual's local banker, to record their departure from South Africa for the application of the Exchange Control Regulations. A tax clearance certificate obtained from SARS would need to accompany the application to financially emigrate. Therefore, when an individual financially emigrates, it is most likely that they will also become a non-resident for tax purposes (Hughes & Crocker, 2018). The concept of Exchange Control Regulations is beyond the scope of this study and will not be considered further.

Previously, if individuals emigrated, they were required to financially emigrate to access their retirement fund benefits (Hughes & Crocker, 2018). However, with effect from 1 March 2021, the concept of emigration for exchange control purposes was removed from the tax legislation to ensure the efficient application of the tax provisions (National Treasury, 2021a:12). TaxTim (2023) explains this change as individuals no longer needing to financially emigrate to withdraw their retirement fund benefit, they now need to tax emigrate, which is done via the residency test. Mac Hutchon (2020:29) identifies three ways to cease being a South African tax resident, namely, ceasing to be ordinarily resident in the republic, no longer meeting the physical presence test requirements, and breaking tax residency in terms of a double tax agreement.

According to Mac Hutchon (2020:39), the Act does not refer to when an individual is no longer considered to be ordinarily resident; therefore, the individual's facts and circumstances regarding their departure from the Republic would need to be considered to determine if they are no longer ordinarily resident for the purposes of the resident definition. Furthermore, if an individual is no longer considered to be ordinarily resident of the Republic, they would need to be physically outside of South Africa, as if they are physically present in the Republic for more than 91 days in the year after they ceased to be ordinarily resident, they would be determined to be a resident in terms of the physical presence test. If an individual who is ordinarily resident in another country is considered a resident of South Africa based on the physical presence test and then exits South Africa with the intention of ceasing to be a South African tax resident, remaining outside the Republic for 330 full days, they will be deemed to no longer be a South African tax resident from the day they cease to be physically present in South Africa. Additionally, Mac Hutchon (2020:42) explains that if an individual is deemed to be a resident in South Africa and another country and a double tax agreement between South Africa and the other country deems that individual to be

exclusively resident of the other country, they will cease to be a South African tax resident on the day determined in such agreement.

The comprehensive guide to the ITR12 income tax return for individuals confirms Mac Hutchon's findings by stating that an individual will not be a South African tax resident in the following two instances: Immediately after ceasing to be physically present in the Republic in terms of the physical presence test, and the individual is out of South Africa for 330 full consecutive days. Secondly, if an individual is exclusively a resident of another country in terms of a double tax agreement between South Africa and another country (SARS, 2023:12).

According to Chambers *et al.* (2021:2), the individual has the onus to inform SARS of their ceasing to be a South African tax resident by indicating on the income tax return (ITR12) that they are no longer a resident and the date on which they ceased to be a resident. Alternatively, the individual can submit a Declaration of Cease to be a Tax Resident form to SARS. In support of the individual ceasing to be a resident, SARS will require documents such as a copy of their passport and a letter of motivation detailing the facts and circumstances that support them ceasing to be a resident.

In summary, individuals currently only access their retirement funds if they have tax emigrated. Tax emigration occurs when the individual no longer meets the resident definition in section 1 of the Act. Therefore, it is important for an individual who emigrates to consider the requirements of the resident definition to determine if they are indeed a non-resident and, as such, tax emigrated. Furthermore, individuals who emigrate must inform SARS of the change in their tax residency.

2.5 Analysis of the tax implications on retirement funds of individuals ceasing their South African tax residency

An individual can cease to be a South African tax resident either before or after retirement, and both circumstances will have different tax implications. If an individual had already retired before emigrating, they would have received one-third of their retirement fund benefit as a lump sum and would have paid tax on it. The remaining two-thirds will be received as monthly annuities and taxed in the year of assessment in which it is received. The tax implications were discussed in more detail in section 2.2 above. However, if an individual ceases to be a resident before retirement, they will not have received their retirement fund benefit. Therefore, the individual would need to withdraw their retirement fund benefit or wait to access their retirement fund benefit when the individual does retire. Section 1 of the Act defines a withdrawal interest as:

“the value of the member’s share of the pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund value, as determined in terms of the rules of the fund on the date on which the member elects to withdraw due to an event other than the member attaining normal retirement age.”

From the above definition, it can be noted that if an individual emigrates, it will be seen as an event other than reaching their retirement; as such, they can access their retirement fund by withdrawing their retirement fund interest. With effect from 1 March 2021, the concept of emigration for exchange control purposes was removed from the tax legislation to ensure the efficient application of the tax provisions (National Treasury, 2021a:12). TaxTim (2023) explains this change as individuals no longer need to financially emigrate to withdraw their retirement fund benefit, they now need to tax emigrate, which is done via the residency test, and explored in section 2.3 above. These changes resulted in individuals who ceased or were planning to cease their South African tax residency only being able to access their retirement annuity fund, pension preservation fund, and provident preservation fund before retirement date if that individual has been a non-resident for at least three consecutive years (National Treasury, 2021a:12). After the passing of the three consecutive years of being a non-resident, the individual will be able to access their retirement annuity fund, pension preservation fund or pension preservation fund, and will be liable to pay the applicable withdrawal tax if they withdraw their retirement fund benefit.

The three-year waiting period is not applicable to pension preservation funds or provident preservation funds if the individual already made a withdrawal from the fund. However, if the individual has not made a withdrawal from the pension or provident preservation fund, the three-year waiting period will be applicable (Baines, 2021). This change does not affect employment-related retirement benefits such as pension or provident funds (EY, 2022). As such, pension funds and provident fund benefits of the individual who emigrates may be withdrawn before they emigrate from South Africa and will be subject to tax on the withdrawal benefit. The National Treasury (2021a:13) notes that an individual may leave their retirement fund benefits in South Africa once they emigrate and only withdraw it at a later stage, for example, when they retire or die.

When an individual, being subject to the three-year waiting period or who retained their retirement fund benefits in South Africa, receives their retirement fund benefits, they will be a non-resident for South African tax purposes. The National Treasury (2021a:12) notes that the retirement fund benefits will be from a South African source. In terms of the Act, non-residents are taxed on South African source income. The source of retirement funds will be discussed in section 2.6 below. The National Treasury (2021a:12) further states that when non-residents access their South African

retirement fund benefits, its taxability needs to be considered with reference to the double tax agreement between South Africa and the individual's new country of residence. This is because the double tax agreement might allow South Africa to tax the retirement funds and, in some cases, South Africa may not tax the retirement funds. What is evident from the above is that the tax treatment of South African source retirement funds benefits of emigrating individuals is not uniform. The tax treatment is based on a few factors, such as whether the individual retired before they emigrated and if the individual is subject to the three-year waiting period. Furthermore, the tax treatment is dependent on the double tax agreement between South Africa and the individual's new country of residence, which determines which country can tax the retirement fund benefits.

2.6 Source of retirement funds

Section 9(2)(i) of the Act deems any lump sums or annuities received or accrued payable by a retirement fund to be from a source within the Republic if the services rendered that led to the lump sum or annuity were rendered in the Republic. If the services were rendered in South Africa and outside of South Africa, then the portion received or accrued in respect of the services rendered in South Africa will be regarded as being from a South African source.

As per section 1 of the Act's definition of gross income part (ii), non-residents are subject to tax on any amount received or accrued from a source within the Republic. Therefore, based on South African domestic tax legislation, SARS may tax the retirement benefits of individuals who ceased their tax residency. As the emigrated individual is now a resident of another country, the new country of residency might also have taxing rights on the retirement benefits, as most developed countries use the residency-based taxation system. This could lead to double taxation of the retirement fund benefit (Fourie, 2007:6). To clarify this, the taxation basis of the USA and the United Kingdom (UK), as well as the double tax agreements between these countries and South Africa, will be explored. In the USA, tax residents or citizens are subject to tax on their worldwide income (IRS, 2024a). The UK also follows a residency-based taxation system, as an individual will be subject to income tax in the UK on their worldwide income if they are a resident and domiciled in the UK (PwC, 2024a). Based on the study of the domestic tax legislation of South Africa, the USA, and the UK, it can be observed that the retirement benefits received or accrued to the former resident of South Africa are liable for tax in South Africa and the new country of residence of the former resident.

In terms of section 108 of the Act, double tax agreements are entered into between South Africa and other countries to avoid the same income being subject to tax in both South Africa and the other country. The OECD (2017a:4) further explains that double tax agreements are entered into without creating opportunities for tax avoidance or tax evasion through non-taxation or reduced

taxation of amounts. It was noted in the *South African Revenue Service v Tradehold Ltd* (2012) JOL 28890 (SCA) that a double tax agreement enjoys preference over domestic law in the case where a conflict arises between the double tax agreement and domestic law (Botha & du Toit, 2021:11). Article 17 of the double tax agreement entered into between South Africa and UK states that any pensions or similar amounts paid due to past employment or annuities will only be taxed in the country to which the individual is a resident of (SARS, 2003:13). From the above, it can be deduced that South Africa will lose its taxing right on the retirement fund benefit received.

SARS (1997:16) refers to Article 18 of the double tax agreement between South Africa and the USA:

“1. Subject to the provisions of Article 19 (Government Service), pension distributions and other similar remuneration derived from sources within a Contracting State and beneficially owned by a resident of the other Contracting State, whether paid periodically or as a single sum, may be taxed by the first-mentioned State under the following conditions:

a) where the USA is the first-mentioned Contracting State, the tax imposed on the pension or similar remuneration may not exceed 15 percent of the gross amount of the pension or similar remuneration, provided that such pension or similar remuneration is not subject to a penalty for early withdrawal; and

b) where South Africa is the first-mentioned Contracting State:

i) the beneficial owner of the pension or similar remuneration has been employed in South Africa for a period or periods aggregating two years or more during the ten-year period immediately preceding the date from which the pension first became due; and

ii) the beneficial owner of the pension or similar remuneration was employed in South Africa for a period or periods aggregating ten years or more.”

The double tax agreement between South Africa and the USA referenced above differs from the South Africa and UK double tax agreement, as it offers, under certain circumstances, the taxing right to the country in which the retirement fund benefit was sourced. As mentioned above, the Act views retirement benefits to be from a South African source if it was earned because of employment rendered in South Africa. If the following two requirements are met, the retirement benefit will be taxed in South Africa, and the USA will lose its taxing right: If the individual who

ceased their South African tax residency worked for two or more years in South Africa over a ten-year period before the date on which the retirement benefit became due; secondly, if the individual worked in South Africa for ten or more years. The term “first due” is not defined in the double tax agreement, which could be a contentious issue. “First due” could be interpreted as the day of retirement or emigration, or it could be interpreted as the day on which the retirement benefit is payable to the individual, which would be the end of the three-year waiting period or the day on which annuities are received.

South Africa and many other countries follow the residency-based taxation system. However, source rules still play a significant role in the residency-based taxation system, especially concerning the taxation of non-residents. This could lead to double taxation, in which case the double tax agreement between South Africa and the other country would need to be considered to determine which country has the taxing right.

2.7 Proposed exit tax on retirement funds of emigrating individuals

As mentioned above, the South African retirement fund tax regime follows the EET system where contributions to a certain limit are exempt via the section 11F deduction of the Act, growth on retirement funds is exempt, and only the retirement benefit received is taxed (Nhabinde & Schoeman, 2008:3). An issue that arises is when an individual emigrates from South Africa prior to retirement, meaning that their retirement fund interests may be subject to tax in the individual’s new country of residence. This will come into effect due to the provisions of the double tax agreement entered between South Africa and the other country. In this case, South Africa might lose its taxing right on these retirement fund benefits. Exacerbating the issue of South Africa losing its right to tax the retirement fund benefit of an emigrating individual is the fact that the individual received tax benefits in the form of deductions on contributions to retirement funds during the years they were South African tax residents (Howell, 2022:10).

To address the non-taxation of retirement funds of emigrating individuals in South Africa, the National Treasury (2021c:18) proposed in the 2021 Draft TLAB to introduce an exit tax on the withdrawal of retirement fund interests when an individual ceases to be a South African tax resident. This was envisaged to be achieved by the proposed amendments to section 9H of the Act and adding section 9HC to the Act. Due to concerns raised by the public in Parliament and through public participatory initiatives, the proposed amendments were withdrawn from the 2021 Draft TLAB (National Treasury, 2021c:21). The proposed amendments have not resurfaced in the subsequent legislative cycles. However, the National Treasury (2021c:21) noted that the proposed amendments will be reconsidered to address the concerns raised in the comment cycle, and further amendments will be considered in subsequent legislative cycles.

Therefore, considering the above, the analysis of the proposed amendment could add valuable insight into future amendments. Section 9H of the Act is proposed to be amended by including paragraph (g) that makes provision for the inclusion of any amount representing the value of an interest in any retirement fund (National Treasury, 2021c:19). Additionally, section 9H of the Act imposes an exit tax on certain assets held by an individual who terminates their South African tax residency. The exit tax is achieved via a deemed disposal of certain assets held by the individual (Botha, 2018:6). Section 9H(4) of the Act specifically excludes certain assets from the exit tax charged on emigration in terms of section 9H(2).

Retirement fund benefits are not listed as one of the excluded assets. However, certain paragraphs in the Eighth Schedule to the Act exclude some disposals from CGT. These CGT exclusions are equally excluded from the exit tax in terms of section 9H(2) of the Act (Botha, 2018:44). Paragraph 54 of the Eighth Schedule to the Act deems that any capital gain or loss arising from a disposal which resulted in an individual receiving a lump sum benefit may be disregarded. The afore-mentioned lump sum refers to a lump sum received from a pension fund, provident fund, pension preservation fund, provident preservation fund, or retirement annuity fund.

Cliffe Dekker Hofmeyr (2021) explains that the above-mentioned exclusion from CGT and from the exit tax in section 9H(2) is the reason why sub-section (g) of section 9H needs to be added to clarify that any amount of interest in any pension fund, pension preservation fund, provident fund, provident preservation fund, or retirement annuity fund is specifically excluded from the exit tax charged in terms of section 9H(2) of the Act. Therefore, section 9HC is proposed to be added to the Act to make provision for the disposal of a retirement fund interest at the change of residency of an individual. As proposed by the National Treasury (2021c:19), section 9HC was drafted to include the following provisions:

- When a South African tax resident individual ceased their residency, they are treated as having disposed of their interest in a retirement fund on the day before they ceased to be a resident.
- The value of the retirement fund benefit that was deemed to be disposed of on change in residency will be treated as a withdrawal benefit.
- Any tax due on the disposal will be subject to interest payable to SARS until the tax is paid.
- The tax on the disposal of the retirement fund interest, is not due and payable until the retirement benefit amount is receivable from the fund by the individual.

- A rebate will be provided for the tax calculated on the disposal of a retirement fund interest on change of residency when the retirement fund benefits become receivable to the individual.

These provisions were envisaged to come into effect on 1 March 2022 and be applicable to all years of assessment starting on or ending after 1 March 2022 (National Treasury, 2021c:19). However, as mentioned above, this proposal was halted and has not yet resurfaced.

The proposed section 9HC deems an individual who ceases to be a South African tax resident to have disposed of their retirement benefits on the date immediately prior to the day on which that person ceases to be a South African tax resident. This deemed disposal will be treated as a withdrawal benefit and taxed using the withdrawal benefits tax table (National Treasury, 2021a:13). The proposed section 9HC(2)(c) delays the payment of tax to when the payment of the retirement fund benefit is receivable by the individual, which is in line with the requirement that individuals cannot withdraw their retirement annuity benefits, pension preservation benefits, or provident fund benefits until they have been a non-resident for at least three consecutive years (Cliffe Dekker Hofmeyr, 2021).

It is noted that an individual may retain their investment in a South African retirement fund vehicle such as a retirement annuity fund, pension preservation fund, or provident preservation fund. However, the deemed disposal in terms of section 9HC will still be applicable. The payment of tax will still be deferred until the date on which the retirement fund interest is obtained by the individual, either via a later withdrawal, retirement, or death. The deemed disposal of retirement fund interests will take place whether the individual withdraws the funds once they emigrate or keeps it in a South African retirement fund for later access. In both cases, the payment of the tax calculated on the deemed disposal will be deferred until the retirement fund benefits are receivable by the individual. Tax will be recalculated using the prevailing tax tables on the date the individual withdraws the retirement funds or receives a lump sum or an annuity. A rebate would be received by the individual for the tax that was calculated on the deemed disposal that occurred when they ceased their South African tax residency (National Treasury, 2021a:13). This is in line with the cumulative principal used when calculating the tax on retirement funds (SARS, 2023:66).

As the payment of tax on the deemed disposal of retirement funds is deferred until the retirement fund interest is received, section 9HC(2)(b) makes provision for interest to be charged on the outstanding tax liability, which is to be at the rate contained in section 189 of the Tax Administration Act 28 of 2011 (TAA) (National Treasury, 2021a:19). Section 189 of the TAA stipulates that interest charged on outstanding taxes will be at the prescribed rate. The prescribed

rate is the interest rate that is gazetted periodically under section 80(1)(b) of the Public Finance Management Act 1 of 1999. The interest will also be deferred until the retirement funds are received by the emigrating individual.

From the above, it can be noted that South Africa follows an EET retirement fund tax regime, under which contributions to the retirement fund and growth in the retirement fund benefit are exempt from tax. The only taxed element is the retirement fund benefits received by the individual. However, in some instances, if an individual ceases to be a South African tax resident, their retirement fund interest may not be subject to tax in South Africa due to the provisions of certain double tax agreements. To prevent South Africa from losing its taxing rights, the National Treasury proposed in the 2021 Draft TLAB to apply a tax on the retirement fund interest of an individual who ceases their South African tax residency. This was proposed to be achieved by amending section 9H of the Act and adding section 9HC to the Act to deem the individual to dispose of their retirement fund interest on the day before they cease to be a South African resident.

The above proposal was envisaged to be implemented from 1 March 2022 for years of assessment starting on or after that date. However, due to concerns raised in the public participatory deliberations, the proposal was withdrawn from the 2021 Draft TLAB. The National Treasury will reconsider the proposal to address the challenges identified and reintroduce it in a subsequent legislative cycle. The challenges raised with this proposal will be explored in section 2.9 below.

2.8 Is the tax on withdrawals of a retirement interest when an individual ceases to be a tax resident an exit tax?

Exit taxes are imposed on taxpayers who terminate their South African tax residency. The concept of exit taxes was introduced as part of the provisions of CGT, which was introduced on 1 October 2001 (Botha, 2018:6). Section 9H(2) of the Act deems an individual that ceases to be a South African tax resident to have disposed of certain of their assets at its market value on the day before they cease to be South African tax residents to determine a CGT charge. The individual is further deemed to have reacquired the assets on the day they cease to be a South African tax resident at the market value determined on the day before they ceased their tax residency. De Broe (2002:34) further explains that an exit tax is in place to recoup any allowances or deductions the taxpayer received and tax the taxpayer on any capital gains or losses that arose during their residency.

The rationale behind imposing an exit tax is to ensure that if a taxpayer ceases their tax residency, South Africa will not lose their taxing right (Ger, 2012). If exit taxes were not imposed on taxpayers

ceasing their tax residency, SARS would experience difficulties collecting the taxes once the asset has been disposed of. Exit taxes are not unique to South Africa; they are used by many open and democratic countries (SARS, 2020:119).

Paragraph 54 of the Eighth Schedule to the Act deems that any capital gain or loss arising from a disposal which resulted in an individual receiving a lump sum benefit may be disregarded. Botha (2018:44) explains that the above exemption from CGT is also excluded from the exit tax in terms of section 9H(2) of the Act. Cliffe Dekker Hofmeyr (2021) states that the above-mentioned exclusion from CGT from the exit tax under section 9H(2) is the reason why sub-section (g) of section 9H must be added. This would clarify that any amount of interest in a pension fund, pension preservation fund, provident fund, provident preservation fund, or retirement annuity fund is specifically excluded from the exit tax charged under section 9H(2) of the Act.

Section 9HC was proposed to be introduced to the Act, which would tax the retirement interest of individuals who cease their South African tax residency. The individual will be deemed to have disposed of their retirement fund benefit on the day before they cease to be a resident. The deemed disposal of the retirement interest will be treated as a withdrawal benefit (National Treasury, 2021a:12). Withdrawal benefits are currently subject to tax using the rates in the withdrawal lump sum benefit tax table (Sanlam, 2019:3).

Du Toit (2021) notes that the proposed section 9HC is triggered when an individual ceases their South African tax residency and deems the individual to have disposed of the retirement interest on the day before they ceased to be a resident. This is the existing exit tax provisions. The National Treasury (2021a:12) explains that the motivation for the proposed section 9HC is to ensure South Africa does not lose its taxing rights on the retirement fund benefits of an individual who ceases their residency. A further motivation is that the individual benefited from the tax deductions for their contributions to the retirement funds. It cannot be argued that the proposed tax on retirement benefits of individuals ceasing their residency is imposed for any other reason than the individual ceasing their residency and, as such, is an exit tax (Du Toit, 2021).

Based on the above, the following was noted: Exit taxes are triggered by the cessation of South African tax residency. The rationale behind exit taxes is to recoup any allowances or deductions an individual receives while a resident. Exit taxes are charged on the CGT inclusion rate, which leads to a lower tax liability.

However, the proposed changes to the legislation that would subject the retirement funds of an emigrating individual to tax states that the exit tax provisions are not applicable to retirement benefits. Furthermore, the envisaged changes state that the retirement benefit will be treated as

a withdrawal benefit, which is subject to tax at the withdrawal lump sum benefit tax table. Thus, it does not seem that the tax on retirement benefits of an emigrating individual will be an exit tax. However, as the tax will be triggered by an individual ceasing their residency and deeming the individual to dispose of their retirement fund benefits, this tax bears the same characteristics as an exit tax.

2.9 Drawbacks of the proposed exit tax in its current form

As mentioned in section 2.7 above, due to the concerns raised via public comment on the 2021 Draft TLAB, the proposed exit tax on retirement fund benefits of emigrating individuals was withdrawn from the 2021 Draft TLAB. This will allow for the issues raised to be addressed so that further amendments can be considered in subsequent legislative cycles (National Treasury, 2021c:21). Some of these concerns are explored below.

2.9.1 Double taxation and double tax agreements

Many of South Africa's double tax agreements concluded with other countries align with Article 18 of the OECD's Model Tax Convention. Article 18 stipulates that retirement funds are taxed in the country of tax residency of the individual. No consideration is given to the source of the retirement funds or the country in which the services were rendered, which led to the retirement funds being received or accrued (Howell, 2022:12). Therefore, if an individual ceases to be a South African resident, they will be taxed in South Africa on their retirement fund benefits in terms of the proposed section 9HC of the Act. Furthermore, the individual might also be taxed on their South African source retirement funds in their new country of residence if the double tax agreement was drafted in line with the OECD's Model Tax Convention. This will result in the individual being subject to double taxation on the retirement fund interests (Botha & du Toit, 2021:8).

Article 23B of the OECD's Model Tax Convention states that when a resident of a country derives income from another country, which is taxed in the source country, the resident country should give a deduction from the tax of the resident an amount equal to the tax paid in the source country. However, it specifically does not allow for the deduction of tax paid in instances where a country has the sole taxing right in terms of the double tax agreement. As Article 18 gives the sole taxing right of a retirement fund interest to the resident country, no deduction will be allowed for tax paid in terms of the proposed section 9HC (OECD, 2017a:16). Botha and du Toit (2021:9) note that the only other way for the individual to get a deduction for the tax paid in South Africa and, subsequently, avoid being subject to double taxation, is if the resident country would give credit under their domestic legislation. However, no mention has been made that the National Treasury

has discussed the possibility with other countries who have sole taxing rights on retirement fund benefits of a resident to allow for a tax credit on the tax paid under the proposed section 9HC in South Africa.

Another contentious issue to consider is treaty override, which is defined as a country enacting domestic legislation that nullifies the provisions of a double tax agreement entered between the two countries (Botha & du Toit, 2021:7). As mentioned above, most double tax agreements entered into between South Africa and other countries, grants the sole taxing rights on retirement funds to the resident country, in which case South Africa loses their taxing right even though the source of the retirement funds is South Africa (Howell, 2022:12). The National Treasury explained that the purpose of the proposed section 9HC is to tax the retirement funds of individuals that cease to be South African tax residents, as South Africa loses their taxing rights due to the provisions of certain double tax agreements (National Treasury, 2021a:12). Botha and du Toit (2021:7) further note that the proposed section 9HC was drafted to circumvent the provisions of the double tax agreements and, as such, constitutes a double tax treaty override.

Following the points mentioned above, conflicts will arise between the different provisions of the Act. The proposed section 9HC will contravene the provisions of section 108 of the Act, as section 108 of the Act makes provision for the double tax agreements to be enacted into law. The provisions of the proposed section 9HC will override the double tax agreements and, as such, will conflict with the provisions in section 108 of the Act. Furthermore, as noted earlier, the court viewed the double tax agreement to get precedence over domestic legislation in the case of conflicts between the two (Botha & du Toit, 2021:11).

Another issue that adds significant complexities to the proposed exit tax on retirement due to change of residency is that a blanket approach was followed when drafting the proposed section 9HC, as no reference is made to instances in which South Africa does not lose their taxing right on retirement funds (Mandy, 2021:5). Article 18 of the double tax agreement between South Africa and the Netherlands reads as follows (SARS, 2009:14):

1. Pensions and other similar remuneration, and annuities, arising in a Contracting State and paid to a resident of the other Contracting State, may be taxed in the first-mentioned State.

The application of the above-noted double tax agreement is that if an individual ceases to be a South African resident and becomes a tax resident in the Netherlands, after which the individual receives retirement fund benefits from South Africa, it will be taxed in South Africa. The gross income definition contained in section 1 of the Act states that non-residents are taxed on South

African source income. As explored in section 2.6 above, retirement funds received because of services rendered in South Africa are from a South African source. Mandy (2021:5) states that instances will lead to unnecessary and significant complexities. The proposed section 9HC will deem the individual to have disposed of their retirement fund interest on the day prior to which they ceased their South African tax residency. However, South Africa will have full taxing rights on retirement fund benefits that non-residents will receive if they withdraw their retirement funds, retire, or die.

The proposed section 9HC does not give thought to individuals who temporarily cease to be South African tax residents due to applying a double tax agreement, with the intention of returning to South Africa. Such an individual will be deemed to have disposed of their retirement funds on the day prior to the day they cease to be a South African tax resident even though the individual is planning to return to South Africa and retire here. Furthermore, the question then arises: When does the retirement benefit become receivable by the individual, as they would be returning to South Africa to either withdraw the interest or retire here? Therefore, the benefit would be a lump sum benefit subject to lower tax (Madden, 2021:8).

2.9.2 Retirement fund benefit amount and interest on the outstanding tax

The proposed section 9HC makes provision for interest to be charged on the outstanding tax liability. A question arises as to how this would work as the tax charged on the deemed disposal of retirement funds only becomes due and payable on the day on which the retirement fund benefits become receivable (Madden, 2021:8). Interest on tax not yet paid is imposed in terms of section 187 of the TAA. The wording of the section notes that interest is charged on “tax debt.” Section 169 of the afore-mentioned act defines “tax debt” as an amount of tax that is due and payable to SARS as levied by a tax act. However, the proposed section 9HC states that the exit tax on retirement funds on change of residence is not due and payable for the purposes of the Act or the TAA until the retirement fund benefit is receivable by the individual.

Another issue that arises is that a significant portion of the retirement fund benefit will be lost because of the interest charged on the outstanding tax amount. This goes against the National Treasury’s goal of encouraging saving for retirement. Furthermore, there is a potential risk that the retirement fund may be reduced to zero due to the tax charged and interest on the outstanding tax or a significant decline in the value of the retirement fund investment. There is also a risk that the tax charged and interest on the outstanding tax may exceed the retirement fund benefit (Chong & Grimm, 2021:2). This, however, will only occur in a remote instance where the individual’s retirement fund benefit value is low, and the individual does not withdraw the funds for a long period.

Howell (2022:12) raises the concern that the proposed section 9HC levies the tax on the deemed disposal of the full value of the individual's retirement fund interest; however, in certain circumstances, the cash flow on exit from the retirement fund will only be one-third of the value of the fund. This is because if the retirement fund is a pension fund, pension preservation fund, or retirement annuity fund, the rules of these funds generally allow the individual to access a maximum of one-third as a lump sum, with the remaining two-thirds used to purchase annuities.

The above analysis explored the drawbacks of the exit tax on retirement funds of individuals ceasing their South African tax residency. The issues identified ranged from individuals being subjected to double taxation, the override of double tax agreements if the proposed changes were enacted in their current form, and uncertainty relating to the interest to be charged on the tax debt. The issues identified above are too serious to ignore, and therefore, the National Treasury's decision to withdraw the proposed exit tax in its current form is justified.

2.10 Comparison of the current tax implications and proposed tax implications on retirement funds of individuals who cease their South African tax residency

Table 2-1 below provides an overview of the current tax implications of retirement funds of individuals ceasing their South African tax residency compared to the proposed tax implications on retirement retirements of individuals ceasing their South African tax residency.

Table 2-1: Comparison of the current tax implications and proposed tax implications on retirement funds of individuals who cease their South African tax residency

	Current tax implications	Proposed tax implications
Individual retires before ceasing to be a South African tax resident	• One-third of the total retirement fund benefit will be taxed once received using the lump sum benefit tax table. • The remaining two-thirds will be taxed in the year of assessment it is received. The taxability of the annuities will depend on which country has the taxing right in terms of the double tax agreement entered between South Africa and the individual's new country of residence. If South Africa has the taxing right in terms of the double tax agreement, the annuities will be taxed using the normal marginal tax rate applicable to the individual.	• The tax implications will be the same as they currently are.
Individual ceases their tax residency before retirement	• Currently, the exit tax provisions do not apply to retirement funds. Therefore, there is no tax applicable to the retirement funds of an individual once they cease to be a South African resident.	• Under the proposed exit tax provisions, the individual will be deemed to have withdrawn their retirement fund benefit on the day before the individual ceased their South African residency.

	• A three-year waiting period is applicable on retirement annuity funds and preservation funds. During this time, the non-resident individual will not be able to access their retirement funds. • Once the individual withdraws or retires from the fund, the benefit received might not be subject to tax in South Africa. This is due to the provisions of certain double tax agreements, which grant the sole taxing right to the country of residency.	• The retirement fund benefit will be taxed as a withdrawal benefit using the withdrawal lump sum tax table. • The tax payment will be deferred until the benefit is received from the fund. Interest will be charged on the outstanding tax liability. • Once the retirement fund benefit is received from the fund, it will be subject to tax again. The tax rate will depend on the circumstances that led to the benefit being received. If the benefit is withdrawn prior to retirement, the benefit will be subject to tax at the withdrawal lump sum rates. If the benefit is received due to retirement, it will be subject to tax at the retirement lump sum benefit rates. • A tax credit will be provided for the tax calculated at the time that the individual ceases to be a tax resident.
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Source: Author's compilation

2.11 Conclusion

This chapter addressed the secondary objective set out in section 1.5.2(i), which was to critically analyse the current tax implications and the proposed tax implications on retirement funds of individuals who are emigrating. This was achieved by analysing the South African tax residency requirements, the conditions for ceasing to be a resident, the source of retirement funds, the current tax on retirement fund benefits of emigrating individuals, and the proposed exit tax on retirement funds.

The justification for the proposed tax on the retirement funds of individuals ceasing their residency - that South Africa loses its taxing rights in certain instances and that the individual benefited from exemptions on retirement fund contributions - was found to be valid. However, the drawbacks of the proposal in its current form, namely, the risk of double taxation on retirement funds, double tax agreement override, and uncertainty on the interest charged, are too significant to reconsider the proposed amendments in its current form. As the National Treasury plans to revisit the proposed amendments in future legislative cycles, an analysis of how it can be achieved is worth exploring.

The subsequent chapter analyses how the USA taxes retirement benefits of emigrating individuals and the international guidelines set out by the OCED. Furthermore, recommendations pertaining to the policy aspects that South Africa should consider when amending the legislation to impose a tax on retirement funds of emigrating individuals are provided.

CHAPTER 3 INTERNATIONAL COMPARISON AND SUGGESTIONS FOR SOUTH AFRICA

3.1 Introduction

Over 40 000 South African taxpayers emigrated in the last five years and thus terminated their South African tax residency (BussinessTech, 2023). When individuals emigrate, consideration must be given to the effect on retirement funds and taxation (Ryan, 2024). According to the National Treasury (cited by Mans, 2021:33), international best practices are considered when developing strategies for South Africa. Thus, the consideration of international tax legislation is important.

Following the discussion of the current tax implications on retirement funds of individuals ceasing their tax residency in South Africa and the proposed exit tax to be charged on retirement fund benefits of individuals ceasing their South African tax residency, a comparison is made in this chapter. This chapter examines the tax implications of retirement fund benefits of emigrating in the USA and international best practices such as the OECD guidelines. The purpose of this is to suggest improvements to the South African proposal to levy an exit tax on retirement funds. This will be done to achieve the secondary objective set out in section 1.5.2 (ii).

This chapter begins by providing a background into why the USA and the OECD were chosen as comparatives, followed by a consideration of the source of retirement funds and the taxing rights of retirement funds; an analysis of the USA tax rules on retirement funds; the retirement funds on emigrating individuals; how the system compares to South Africa; and an analysis of the OECD's Model Tax Convention taxing rights on retirement funds, which includes suggestions on approaches South Africa could follow.

3.2 Background

The USA has been selected for the international comparison as an exit tax is levied on retirement funds of individuals who cease to be a USA resident via a deemed disposal (Diosdi, 2022). Furthermore, the OECD (2020) notes that the USA has been a member of the OECD since 1961, signifying that the USA have well-established tax policies that would include policies regarding the taxation of retirement funds, with a specific focus on individuals who are emigrating. The UN Statistics Division (2022) classifies the USA as a developed country, whereas South Africa is classified as a developing country. Comparing South Africa to a developed country, such as the

USA, could help South Africa to improve the tax legislation regarding the taxation of retirement funds of individuals ceasing their tax residency.

Arnold (2013:1) opines that the most prominent model treaties are the OECD's Model Tax Convention and the UN's Model Taxation Convention between Developed and Developing Countries (Model Convention). South Africa is currently not a member of the OECD. However, South Africa is a key partner to the OECD, which results in South Africa's participation in the OECD's daily work, providing beneficial perspectives and contributing to the relevance of policy debates. Furthermore, continuous engagement leads to strengthened co-operation and working towards reaching OECD standards (OECD, 2020). In July 2023, South Africa and the OECD signed a five-year memorandum of understanding, which will assist South Africa in realising its economic potential and assisting South Africa in working towards reaching the OECD standards and practices (OECD, 2024). Mans (2021:21) notes that the National Treasury publications reference OECD principles due to the relationship and work undertaken between South Africa and the OECD.

The UN is an international organisation comprising 193 member states, including South Africa, that work together to solve issues facing humanity (UN, 2024). The UN (2017:3) published a Model Convention to guide countries when developing double tax agreements to circumvent double taxation and promote investment. Du Plessis (2012:31) notes that the OECD's Model Tax Convention is the most influential model tax treaty and is relied upon by OECD member countries and non-member countries, such as South Africa, when drafting double tax agreements. Therefore, more focus is placed on the OECD's Model Tax Convention.

3.3 Source and taxing right of retirement funds

Model Tax Conventions, on which most double tax agreements are based, provide for taxing rights to be granted on the residency and source principles (UN, 2017:3). Therefore, it is essential to consider the source country of the retirement funds. The UN's Model Convention generally provides the source country with taxing rights compared to the residency country. Article 18 of the UN's Model Convention offers two alternatives for the taxation of retirement funds, one being that the residency country has the taxing right and the other being that the source country has the taxing right (UN, 2017:419).

In contrast to the UN Model Convention, the OECD Model Tax Convention stipulates that retirement funds are taxed in the country of the individual's tax residency. No consideration is given to the source of the retirement funds or the country in which the services were rendered, leading to the retirement funds being received or accrued. Most double tax agreements are based

on the provisions of the OCED Model Tax Convention (Howell, 2022:9). The OECD Model Tax Convention does, however, include alternative provisions to the sole taxing right awarded to the residency country. These provisions range from exclusive to limited source taxing rights (OECD, 2017b:346). In the Model Tax Convention, the OECD (2017b:347) notes that if the source country has taxing rights, the term source of retirement funds needs to be clearly determined. This is due to potential confusion if the term “arising in” is used. The source country could be seen as the country where the fund is established, where the work that led to the retirement benefit was performed, or where deductions were claimed. The source issue is exacerbated by the fact that an individual can work in many countries during their career (OECD, 2017b:348).

The UN Model Convention stipulates that the source of retirement funds should be the country in which payments originate, which in essence will be the country in which the fund is established (Mans, 2020:27). The rationale behind this is that if the source of retirement funds is the country where the services were rendered, and an individual has worked in multiple countries, a risk arises that different portions of the same retirement fund could be taxable in multiple source countries. This could lead to uncertainty and administrative challenges for both the individual and the tax authorities (UN, 2017:427). On the other hand, the OECD disagrees with this view. An individual may spend a significant amount of time rendering services in another country than the one in which the fund is established. Since little to no work was performed and resources were not used in the country where the fund was established, it will be difficult to justify it as the source country (OECD, 2017b:348).

An alternative to the above is that the source country will be the country where the services were rendered (OECD, 2017b:347). As part of the remuneration for services rendered, employers often provide individuals with retirement benefits. This shows an implicit relationship between employment and retirement fund benefits. This supports the view that the source of retirement fund benefits is the country where the services were rendered (Mans, 2020:28). Therefore, the source country of income from employment is the country where the services were rendered. Such income will be taxable in the country where the services were rendered (OECD, 2017b:305). Mans (2020:28) notes that the same principle is applicable to the source of retirement fund benefits as it relates to past employment.

When double tax agreements are drafted to include exclusive or limited source taxing rights, the countries involved need to determine which country will be the source of the retirement funds. This should include wording on how the source country should be interpreted and applied (OECD, 2017b:347-348). The double tax agreement between South Africa and the USA does not define which country is the source country of the retirement fund benefits. The term “derived from

sources within a Contracting State” is used in the double tax agreement (SARS, 1997:16). Article 3 states that any term not defined in the double tax agreement will be defined in terms of the legislation of the country to which the taxes apply in terms of the double tax agreement (SARS, 1997:4). South Africa views the source of retirement funds as the country in which the services were rendered. If the services were rendered in more than one country, then they should be apportioned based on the services rendered in the country as a percentage of the total services rendered. This is in terms of section 9(2)(i) of the Act. The USA also views the source of retirement funds as the country where the services were performed that resulted in that retirement fund (IRS, 2024b).

From the above, it can be noted that the UN Model Convention favours the view that the source country should tax the retirement funds received by residents of another country. On the other hand, the OECD Model Tax Convention favours the exclusive taxing rights on retirement funds to be granted to the individual’s residence country. Most double tax agreements are drafted following this view. However, some countries allocate tax rights to the source country, either exclusively or partially. In cases where the source country has taxing rights, the countries that are party to the double tax agreement need to agree on what will constitute the source country of retirement fund benefits. Both South Africa and the USA view the source country of retirement funds as the country where the services were rendered.

In the next section of the chapter, the USA tax implications of retirement funds will be considered, including the tax implications of retirement funds when an individual ceases their USA residency. Firstly, a background on taxation in the USA will be provided.

3.4 United States of America

3.4.1 Background

The Internal Revenue Service (“IRS”) is the tax authority in the USA and is responsible for the collection of taxes (PwC, 2024b). The tax legislation applicable is the Internal Revenue Code of 1986, which is found in Title 26 of the United States Code (IRS, 2024c). The tax year for an individual in the USA is from 1 January to 31 December (PwC, 2024b). Like South Africa, the USA taxes residents on worldwide income, whereas non-residents are taxed on USA source income and income effectively connected to a trade or business in the USA (IRS, 2024a). USA source income that is fixed, determinable, annual, or periodical is taxed at a flat rate of 30% or a lower rate if a double tax agreement is effective. On the other hand, income connected to a USA trade or business is taxed at the same rates applicable to USA residents (IRS, 2024d). The next sub-section will consider the tax implications of retirement fund benefits in the USA.

3.4.1.1 Taxation of retirement fund benefits

The most common types of retirement plans in the USA are the 401(k), an employment retirement plan, and an individual retirement account normally opened and managed by the individual. Under these two plans, there are various sub-categories. The key aspects differentiating these types of funds are the contribution limits, withdrawal rules, and tax benefits (Faden, 2023).

3.4.1.1.1 401(k) retirement plans

The 401(k)-retirement plan can be divided into two different types, namely, a traditional 401(k) and a Roth 401(k). No deductions are available for contributions made to a 401(k)-retirement plan. Contributions to a traditional 401(k) are normally made before federal taxes are calculated on employment income. Therefore, these contributions have no income tax; traditional 401(k) contributions reduce an individual's taxable income. Employer contributions to an employee's 401(k) is also not taxable, subject to a limit. Roth 401(k) retirement plans differ from the traditional 401(k) in that contributions are made from money that has already been taxed (Thomson Reuters, 2024a).

The tax-free portion of contributions to a 401(k) plan is subject to two annual limits. The employee's contribution limit is \$23 000 for the 2024 tax year. The second limit is the overall limit on all contributions, which is the lesser of 100% of the employee's compensation or \$69 000 for the 2024 tax year. If an individual contributed more than the limit, they could either withdraw the excess or leave it in the fund. If the individual wants to withdraw the excess, they will need to withdraw it before 15 April of the following tax year. The excess contribution would be subject to tax in the tax year in which the contribution was made. No penalty on early distribution will be applicable. However, if the individual does not withdraw the excess contribution before 15 April of the following tax year, the excess contribution will be subject to tax in the tax year in which the excess contribution was made. Additionally, the excess contribution will be taxed again once the individual withdraws from the fund. Therefore, the excess contributions will be subject to tax twice (IRS, 2024e).

As the contributions to a traditional 401(k) plan are not taxed, the distributions will be taxed. On the other hand, distributions from a Roth 401(k) are generally not taxed as the money used to contribute was subject to tax. Distributions are to be received once the individual reaches the age of 59½ years. At this time, the distributions from a traditional 401(k) will be subject to tax at the normal rate applicable to the individual. If an individual withdraws funds from a 401(k) before the age of 59½ years, a 10% early withdrawal penalty will apply. However, there are various exemptions from the 10% penalty that an individual could qualify for (Thomson Reuters, 2024a).

3.4.1.1.2 Individual retirement account

The second type of common retirement fund in the USA is the individual retirement account. Like the 401(k), the individual retirement fund can also be divided into two types, namely, a traditional individual retirement account and a Roth individual retirement account. Contributions to a traditional individual retirement account could qualify for a tax deduction if certain requirements are met. Contributions to Roth individual retirement accounts cannot qualify for a tax deduction as the money used to make the contributions was already subject to tax (Thomson Reuters, 2024b). The tax deduction applicable to traditional individual retirement accounts is not a fixed amount or percentage, but rather based on factors such as income, whether the individual fills their taxes alone or with a spouse, and whether the individual or their spouse is part of a workplace retirement plan (Hayes, 2024).

Contributions to an individual retirement account are subject to a limit. The annual limit for a traditional individual retirement account is \$7 000 for individuals under the age of 50 and \$8 000 for individuals aged 50 or older. Contributions to a Roth individual retirement account are subject to the lesser of the above annual limits or the equivalent of the individual's earned income. Earned income must be declared for tax purposes, such as salaries, wages, bonuses, dividends, and business income. Excess contributions may be subject to a six percent penalty for each year they remain in the account. However, individuals may withdraw the excess contributions plus growth or reassign the excess contributions to the next year of assessment. This needs to be done before the April tax filing deadline. If the excess contributions and growth are withdrawn, they may be subject to taxes and a 10% early withdrawal penalty (Hayes, 2024).

Distributions received from a traditional individual retirement account after the age of 59½ years are subject to tax at the individual's normal tax rate. Withdrawals from a traditional individual retirement account before the age of 59½ years may be subject to an early withdrawal penalty of 10% if the individual does not qualify for an exemption from the penalty. Distributions received from a Roth individual retirement account after the age of 59½ years and if the account has been open for at least five years will usually be tax-free. If funds are withdrawn from a Roth individual retirement account before the age of 59½ years or if the fund has not been open for five years, it could be subject to tax and a 10% penalty (Thomson Reuters, 2024b).

Based on the above, the following can be noted: the 401(k) and individual retirement accounts are the USA's two most common retirement fund plans. The 401(k) is linked to employment, whereas the individual retirement account is a plan the individual may take part in on their own. Both the 401(k) and individual retirement accounts can be split into a traditional plan and a Roth plan. Contributions made to traditional plans are tax-exempt, subject to a limit. Therefore, the

distributions will be subject to tax. On the other hand, contributions to Roth plans are made from money that has already been taxed; therefore, the distribution will be exempt from tax.

3.4.1.2 Taxation of retirement fund benefits for individuals ceasing their tax residency

The USA taxes residents on worldwide income. On the other hand, non-residents are taxed on USA source income and income effectively connected to a trade or business in the USA (IRS, 2024a). Individuals who relinquish their USA citizenship or green card may be subject to an exit tax known as an expatriation tax (Deloitte, 2022:1).

Expatriation tax applies to individuals who relinquish their USA citizenship on or after 17 June 2008 or former long-term residents who relinquish their green card. Furthermore, these individuals need to meet one of the following three requirements: The individual's net worth was at least \$2 million; the individual's average annual net tax liability over the five preceding years before expatriation was higher than the required amount, which is \$201 000 for the 2024 tax year and is adjusted each year for inflation; lastly, if in the five years before expatriation, the individual did not certify that all USA tax obligations were satisfied. An individual who meets the above requirements is known as a covered expatriate (Deloitte, 2022:2). Wallace (2024) notes that the expatriation tax is specifically for high-net-worth individuals.

Two very limited exceptions to the above-highlighted expatriate rules apply, namely, the dual-citizen and minor child exceptions. The dual-citizen exception is applicable if the expatriate individual is a dual-citizen because of being born with dual citizenship of the USA and another country; furthermore, if the individual retains their non-USA citizenship and is taxed as a resident of another country; lastly, if the individual has not been a resident for more than 10 years during the 15 tax years before the expatriation year. The second exception is applicable if the individual renounces their USA citizenship before the age of 18½ years and the individual has not been a resident for longer than 10 years before the expatriation (Deloitte, 2022:4).

A covered expatriate will be deemed to have disposed of certain assets at their fair market value the day before the individual expatriated (Deloitte, 2022:1-2). The above-deemed disposal and subsequent expatriation taxation also apply to certain retirement funds (EY, 2024:1683). For purposes of expatriation tax, retirement benefits are categorised into three categories. Eligible deferred compensation and ineligible deferred compensation refer to employer retirement funds, such as the 401(k) plan. Under eligible deferred compensation, the individual elects that the payment of expatriate tax is deferred until the distribution is received from the retirement fund, which is subject to certain requirements being met. Under the ineligible deferred compensation category, no tax deferral election is made, and the requirements for the tax deferral are not met.

The last category is tax deferred accounts, which relate to individual retirement accounts (Deloitte, 2022:3).

For all three categories discussed above, the retirement benefit will be deemed to have been distributed to the individual on the day before the expatriation date (Deloitte, 2022:4). The expatriate tax will be calculated at the current value of the interest in the retirement fund on the day before the expatriation day (EY, 2024:1683). The deemed distribution will be subject to tax at the normal tax rate applicable to the individual. However, the 10% early withdrawal penalty will not be applicable if the expatriating individual has not reached the retirement age of 59½ years (Deloitte, 2022:4).

Under the eligible deferred compensation, the individual may elect to defer the payment of the expatriate tax until a distribution is received from the retirement fund. This election may only be made if sufficient security can be provided and the IRS approves the election. The election made by the individual to defer the tax payment is irrevocable, and interest will be levied on the deferred payment. Additionally, the individual waives any right to claim a withholding tax rate reduction under a double tax agreement (EY, 2024:1683). When the individual receives the distribution, it will be received after the fund administrator withholds tax at a rate of 30% of the taxable portion of the distribution (Deloitte, 2022:3).

If the individual elects to defer tax payments on their retirement funds, as discussed above, the outstanding tax liability will be subject to interest. The interest will be charged from the day before the individual is expatriated until the tax is paid. The interest will be compounded daily at the underpayment rate (IRS, 2009:12). In terms of Section 6621 of the Internal Revenue Code, the underpayment rate is the federal short-term rate plus three percent. The rate is determined quarterly (Federal Register, 2024).

Once the individual expatriates, they become non-residents for USA tax purposes. As mentioned above, non-residents are taxed on USA source income and income effectively connected to a trade or business in the USA (IRS, 2024a). From the above discussions, it was also evident that the USA views the source of retirement funds as the country where the services were performed that resulted in that retirement fund (IRS, 2024b). Therefore, once the expatriate individual receives retirement fund benefits from services rendered in the USA, it will be subject to tax in the USA.

As mentioned above, retirement funds considered to be eligible deferred compensation are subject to tax at a rate of 30% of the taxable portion of the distribution (Deloitte, 2022:3). Distributions from retirement funds that are tax deferred accounts, such as individual retirement

account, will be subject to withholding tax at a rate of 30%. Additionally, the early withdrawal penalty may also be applicable (Diosdi, 2022). In contrast, distributions received from a retirement fund that is an ineligible deferred compensation are taxed at the rates applicable to a USA tax resident. This is due to the distribution being seen as income earned that is effectively connected to a trade or business (IRS, 2024f).

Retirement funds that fall under the ineligible deferred compensation and tax deferred account categories were subject to expatriation tax on the fund's value on the day before the day of expatriation (EY, 2024:1683). Therefore, when an expatriate individual receives the distribution from these funds, and tax is calculated, an appropriate adjustment will be made to account for the expatriation tax that was previously paid. This is done to avoid the same benefit being subject to USA federal tax twice (IRS, 2009:16-19).

Based on the above, the USA has an exit tax in place. The exit tax does not apply to all individuals who cease their residency, but only applies to individuals meeting certain requirements. The individual will be deemed to have disposed of their retirement fund benefit on the date before the date the residency was ceased, and tax will be levied on that deemed disposal. When an individual receives the retirement fund benefit, it will be subject to tax again as it is from a USA source. An adjustment will be made for the tax paid on the retirement fund benefit when the individual ceases residency. Under certain retirement funds, subject to the requirements being met, the individual may elect to have the exit tax deferred until the benefit is received.

The USA has concluded double tax agreements with several countries. Under the provisions of these double tax agreements, the USA tax on certain income of the non-resident may be reduced or eliminated. Therefore, consideration needs to be given to the double tax agreement when the USA tax is imposed on the income of a non-resident (IRS, 2024f).

3.4.2 Double tax agreements

The USA has its own Model Income Tax Convention, which is used as a basis when double tax agreements are entered with other countries. The 2016 Model Income Tax Convention is the latest version. While this is only a model double tax agreement and is therefore not effective between the USA and other countries, it does, however, reflect the current USA treaty policy and is used if any treaty is being renegotiated (EY, 2016).

Article 17 of the Model Income Tax Convention deals with retirement benefits and other remuneration of a similar nature. In terms of paragraph 1(a), exclusive taxing rights are granted to the residence country of the individual if the resident beneficially owns the retirement benefit

(U.S. Department of the Treasury, 2016:34). Paragraph 4 of Article 1 of the Model Income Tax Convention includes a saving clause. This preserves the right of a residence country to tax its residents as if the double tax agreement was not. Furthermore, it also includes a provision that allows a country to tax a former citizen or former long-term resident in terms of the tax laws of that country. Paragraph 4 is subject to paragraph 5, which includes certain items that are excluded from the provisions of paragraph 4. Retirement benefits and similar remuneration addressed in paragraph 1(a) of Article 17 are not one of the exclusions (U.S. Department of the Treasury, 2016:2-3).

3.4.3 Comparison with South Africa

The following discussion is based on the information considered above. The retirement systems in South Africa and the USA differ in the fact that South Africa treats all retirement funds as tax deferred. Tax is only applicable to retirement benefits once it is received from the fund. Growth and contributions subject to a limit are not taxed. On the other hand, retirement funds in the USA can either be tax deferred or not taxed if the contributions were made from money that was already subject to tax. For the purposes of the comparison between the two countries, only tax deferred retirement funds will be considered (see sections 2.2, 3.4.1.1 and 3.4.1.2).

Both South Africa and the USA view retirement fund benefits as being from a source within the country if the retirement fund benefit resulted from services rendered within the country. Therefore, once such retirement fund benefits are received by a resident, they will be subject to tax. In South Africa, retirement fund benefits are subject to tax using different tax tables depending on the nature of the benefit and when in the individual's life it is received. Lump sums received from a retirement fund once the individual has retired will be subject to tax at rates in the retirement lump sum benefit table, which is more favourable than the normal tax rates applicable to individuals (see sections 2.2 and 3.3).

Lump sum benefits received from a retirement fund before the individual has retired are subject to tax at the withdrawal lump sum table. This table is stricter than the retirement lump sum table but more favourable than the rates in the normal tax table applicable to individuals. Annuities are taxed at the normal tax rates applicable to an individual. The USA, however, taxes all retirement benefits received using the normal tax rates applicable to individuals. However, a 10% penalty is applicable to any distributions received before the minimum age of 59½ years (see sections 2.2, 3.4.1.1 and 3.4.1.2).

Currently, the exit tax provisions in South Africa do not apply to retirement fund benefits. Therefore, generally, when an individual emigrates from South Africa, there is no tax on the value of their retirement fund benefits. On the other hand, the USA imposes an expatriate tax on the retirement funds of high-value individuals who emigrate from the USA. The individual is deemed to have received a distribution from the retirement benefit on the day before emigration. The deemed distribution is taxed at the normal tax rates applicable to the individual. However, the individual may elect to defer tax payment on certain retirement funds if all the requirements are met when the distribution is received (see sections 2.7 and 3.4.1.2).

Both South Africa and the USA have concluded double tax agreements between themselves and other countries. These double tax agreements dictate which country has the taxing right on income received; many double tax agreements grant the residence country the taxing right on retirement benefits received. Thus, when a non-resident of South Africa receives South African source retirement funds, the retirement benefit might only be taxable in the individual's new country of residency. The USA taxes the retirement fund benefits of expatriates again once the non-resident individual has received the benefit. However, an adjustment is made to account for the value of the retirement fund benefit, which was subject to tax when the individual emigrates. The USA negotiates double tax agreements to include a saving clause that would allow the USA to tax their current and former residents in terms of domestic legislation as if the double tax agreement was not entered into. To avoid double taxation, the USA provides a credit for any foreign taxes paid on amounts that are also subject to USA taxation (see sections 2.7, 3.4.1.2 and 3.4.2).

The exit tax that South Africa wants to introduce on retirement funds does not differ from the expatriate tax that the USA has in place. Under the proposed exit tax provisions on retirement funds in South Africa, the individual will be deemed to have disposed of their retirement fund benefit on the day before the individual emigrates. Tax will be calculated on the benefit using the withdrawal tax table. The interest payment will be deferred until the retirement benefit is received. Interest will be calculated on the outstanding tax. Once the retirement benefit is received, it will be subject to tax again; however, a tax credit will be provided for the tax calculated when the individual emigrates (see section 2.7). However, this approach could lead to double taxation. As the source country, South Africa will be imposing a tax on the retirement benefit received, and the country of residency of the individual will also be imposing tax on the same income. South African double tax agreements do not include a saving clause, as is the case with the USA (see sections 2.9 and 3.4.2).

A possible solution to the double taxation issue would be for South Africa to follow the approach used in the USA by including a saving clause in double tax agreements. The saving clause will allow South Africa to tax its former residents as if the double tax agreement had not been entered into. However, to achieve this, South Africa would need to renegotiate the double tax agreement it entered into with other countries. With the saving clause in place, the other country is set to lose its taxing rights, raising concerns as to whether the countries would agree to renegotiate the double tax agreements. Furthermore, South Africa would need to allow a tax credit for any foreign taxes imposed by the individual's country of residence on the South African source retirement funds (see section 3.4.2).

3.4.4 Summary of the comparison with the United States of America

There are many differences between the retirement systems and the subsequent taxation of retirement benefits between South Africa and the USA. One difference identified is that the USA offers both taxed and tax-free retirement fund contributions. The main difference, however, relates to the taxation of local source retirement funds in the hands of non-residents. The USA imposes an exit tax on high-value emigrants, which is also applicable to retirement fund benefits. Furthermore, the USA also taxes the locally sourced retirement fund benefits received by non-residents. The current exit tax provisions in South Africa do not include retirement funds.

Furthermore, certain double tax agreements between South Africa and other countries cause South Africa to lose their taxing right on South African source retirement funds. South Africa proposed introducing an exit tax on retirement funds. However, this proposal was withdrawn due to issues raised on it, such as the risk of double taxation and the override of the double tax agreement. While there are differences between the retirement systems and retirement fund benefit taxation between South Africa and the USA, South Africa could consider the USA as a comparative country when considering legislation to introduce an exit tax on retirement funds of emigrating individuals.

The next section of the chapter will consider the OECD's Model Tax Convention policy on the taxing rights of retirement funds. This will be done to achieve the secondary objective, which is to analyse international practices such as the OECD guidelines to suggest improvements to the South African proposal to levy an exit on retirement funds.

3.5 OECD's Model Tax Convention policy on the taxing rights of retirement funds

As companies and individuals started engaging in commercial and financial activities in more than one country and became exposed to differing tax implications in these countries, a need arose

for clarity and unification of the different tax implications. The OECD developed the Model Tax Convention to provide uniform principles, definitions, and rules to address common issues that arise in international tax. This assisted in reducing the risk of double taxation and preventing tax avoidance and tax evasion through mutual co-operation between countries on tax collection (OECD, 2017b:9).

Article 18 of the OECD's Model Tax Convention deals with the taxation of retirement funds, with the exception of retirement funds government service, which is dealt with in terms of Article 19. Article 18 only deals with retirement funds that arose as a result of employment. Furthermore, Article 18 deals with all retirement fund benefit payments, such as lump sums, annuities or similar payments that arose because of past employment. It also includes payments made to the beneficiaries of the former employee (OECD, 2017b:343).

Countries have different retirement fund regimes, which can be classified as statutory social security, employment retirement schemes, and individual retirement schemes. This adds more complexity to international tax rules as countries rely on different categories of retirement funds to ensure individuals have retirement savings. Countries may have varying tax rules for each category; therefore, these differences must be considered while drafting double tax agreements to avoid non-taxation or double taxation (OECD, 2017b:345). In the following sub-section, Article 18 of the OECD's Model Tax Convention, which deals with the taxation of retirement funds, will be analysed.

3.5.1 The country of residence has the taxing rights on retirement funds

In terms of Article 18 of the OECD's Model Tax Convention, retirement funds are only taxable in the country of residence of the individual. The rationale behind this is that the individual's country of residence has a better understanding of their overall ability to pay tax. This also reduces the administrative burden on the individual to comply with multiple countries' tax laws (OECD, 2017b:343). South Africa has concluded many double tax agreements that follow the principles of Article 18 of the OECD's Model Tax Convention, which grants the exclusive taxing right on retirement funds to the residence country. These include the double tax agreements concluded by South Africa with Australia, Denmark, Germany, Italy, New Zealand, the People's Republic of China, Portugal, Spain, and the UK (Botha & du Toit, 2021:7).

An individual's country of residence is determined in terms of the domestic legislation of that country. Another country's domestic legislation might also view an individual as a resident in that country due to various factors, in which case, the individual's residence will be determined by reference to the double tax agreement between the two countries (SARS, 2018b). Not all

countries grant exclusive taxing rights on retirement funds to the resident country, as per the guidelines of Article 18 of the Model Tax Convention (OECD, 2017b:343). The analysis of the OECD's Model Tax Convention will be continued below by considering the justification for allocating taxing rights on retirement funds and how the allocation of taxing rights works.

3.5.2 Allocation of taxing rights on retirement funds

Whitehouse (1999:5) explains that there are various types of taxation systems for retirement funds. The most common is the EET system, under which the exemptions and growth are exempt from tax, and the retirement fund benefits will be taxed. This is the system followed by South Africa. The second system is the taxed, exempt, exempt (TEE) system, under which the contributions to retirement funds are taxed. Meanwhile, the growth of retirement funds and retirement fund benefits are not taxed. The next system is the taxed, taxed, exempt (TTE) system, where the contributions and growth on the retirement funds are taxed, but the retirement fund benefits will be exempt from tax. The last system is the exempt, taxed, taxed (ETT) system, which exempts the contributions, but taxes the growth of the fund and the retirement fund benefits received (Whitehouse, 1999:5).

Countries follow different tax systems relating to retirement funds, which results in issues such as mismatches in the tax policy (OECD, 2017b:345). The mismatches arising from the different tax systems are due to the varying retirement fund exemption and taxation rules, which apply at different stages: when contributions are made to the retirement fund, when there is growth in the fund, and when retirement fund benefits are received (Stenlund, 2020:1). If the individual's country of residence and source country of retirement funds follow a similar approach by taxing retirement fund benefits when received, then the issue is merely the allocation of taxing rights between the two countries. However, if the individual's country of residence does not tax the retirement fund benefits when received, then the mismatch of policies will result in no tax being paid on the retirement fund benefits received (OECD, 2017b:346).

Based on the above, some countries conclude double tax agreements by including exclusive or limited source taxing rights on retirement funds. These countries must consider and agree on these provisions when negotiating these double tax agreements (OECD, 2017b:346). The OECD's Model Tax Convention is merely a recommendation to members and is not binding. Therefore, member countries use the provisions of the Model Tax Convention as a basis for developing double tax agreements by using the wording used in the model or using the wording of the model with some adjustments.

Countries may deviate from the model to include alternative provisions to address the challenges faced (McIntyre, 2010:7). Another issue that may arise is when individuals move to a country with a lower tax rate on retirement funds than the source country or to a country that does not tax retirement fund benefits when received. This issue will be compounded if the source country grants deductions for the contributions to the retirement fund and does not tax the growth (OECD, 2017b:347). The OECD (2017b:348) Model Tax Conventions commentary includes examples of alternatives to the resident country's exclusive taxing right, which will be considered next.

3.5.2.1 Provisions allowing exclusive source taxation of pension payments

Under this provision, the Article dealing with retirement funds in the double tax agreement concluded between two countries will be drafted to allow the retirement funds arising from past employment in a country to be solely taxed in that country and not in the country of residence of the individual. This will be subjected to the provisions of paragraph 2 of Article 19 (OECD, 2017b:347). Article 19 deals with any remuneration received because of any government services performed in a country, which will only be taxed in that country (OECD, 2017a:17).

3.5.2.2 Provisions allowing non-exclusive source taxation of pension payments

The following provision could be used to either grant exclusive or limited source taxing rights on retirement funds by allowing non-exclusive source taxation. This will be achieved by drafting the double tax agreement to grant taxing rights to the country of residence. It will also allow the source country to tax the retirement fund benefits since they result from services rendered in that country. This will be done with reference to Article 23 A or Article 23 B. Therefore, both the residency and source countries may tax the retirement fund benefit. However, the residency country will either exempt the retirement income that was subject to tax in the source country or provide a tax credit for the tax paid to the source country. This provision will be subject to paragraph 2 of Article 19, which was explained in section 3.5.2.1 above (OECD, 2017b:347).

Article 23 deals with the methods of eradicating double taxation. Article 23 A follows the elimination method, which states that if a resident of a country receives income or capital from another country taxed in that country in line with the provisions of the tax convention, then the country of residence will exempt the income or capital from tax. However, if the country of residence has the sole taxing right on the income or capital in terms of the tax convention, then the country of residence is not obligated to allow for a tax exemption on the income or capital that was taxed by another country (OECD, 2017a:19).

If the income or capital is exempt from tax in the resident country by virtue of the provisions of the tax convention, the resident country will still consider the exempted income or capital when determining the tax on such income or capital. Article 23 B, on the other hand, follows the credit method, which states that if a resident of a country receives income or capital from another country which is taxed in that country in line with the provisions of the tax convention, then the country of residence will grant a tax deduction for the tax paid in the other country on the income or capital when determining the tax on such income or capital. However, if the country of residence has the sole taxing right on the income or capital in terms of the tax convention, then the country of residence is not obligated to allow for a tax exemption on the income or capital that was taxed in another country. If the income or capital is exempt from tax in the resident country by virtue of the provisions of the tax convention, the resident country will still consider the exempted income or capital when determining the tax on such income or capital (OECD, 2017a:19-20).

3.5.2.3 Provisions allowing limited source taxation of pension payments

Under the provisions allowing limited source taxation of pensions, the retirement fund Article in the double tax agreement between the two countries will be drafted to allow the retirement fund benefits received due to past employment by a resident of a country to be taxed in the resident country. It will also allow the source country to tax the retirement fund benefits received in terms of its tax laws. However, the taxation will be subject to a limit, which could be a percentage of the retirement fund benefit received. This provision will be subject to paragraph 2 of Article 19. Article 23 A will also be amended if this provision is applied to include a reference to the retirement fund article. This will allow the resident country to tax the retirement fund benefit, and the resident country will provide a tax credit for any tax paid on the retirement fund benefit in the source country (OECD, 2017b:347).

3.5.2.4 Provisions allowing source taxation of pension payments only where the state of residence does not tax these payments

The final provision, which grants either exclusive or limited source taxing rights on retirement funds, will be implemented by drafting the retirement fund article of the double tax agreement to specify that retirement fund benefits received by an individual will be taxed in the source country, provided these benefits are not taxed in the individual's country of residence under its tax laws (OECD, 2017b:347).

3.5.2.5 Conclusive remarks on the taxing rights provisions

Based on the above, it is noted that the OECD prefers that the individual's resident country taxes the retirement funds received from another country. The reason behind this is that the individual's residency country has a better understanding of the individual's overall ability to pay tax, and it will also assist the individual in not needing to comply with multiple countries' tax laws.

However, the OECD provides alternatives to the sole taxing right provided to the resident country. These alternatives range from the source country being allowed full taxing rights to both the source country and resident country taxing the retirement funds, with the resident country providing relief for taxes paid in the source country on the retirement funds.

3.5.3 Approaches South Africa could follow

Based on the information presented above, the following approaches have been put forward: The OECD's Model Tax Convention prefers that the country of residence have the taxing rights of retirement fund benefits. Most of the double tax agreements concluded by South Africa follow the OECD's Model Tax Convention view of the residency country having the taxing right on retirement funds. This will lead to an individual being subject to double taxation on retirement fund benefits if the proposed exit tax is introduced in its current form. This is because South Africa imposed the exit tax on retirement fund benefits as the source country, and the country of residency of the former South African resident will also tax the retirement fund benefit (see sections 2.9.1 and 3.5.1).

Not all countries follow the exclusive residency taxing right view. Therefore, the OECD's Model Tax Convention commentary includes examples of alternative provisions to the residency country's exclusive taxing right. South Africa could consider using these provisions to avoid double taxation on the retirement fund benefits (see section 3.5.2). The first alternative provision would be for South Africa and other countries to conclude the double tax agreement to allow the source country to solely tax the retirement fund benefits from past employment in that country. The second alternative would be for South Africa and other countries to conclude the double tax agreement by allowing both the residency and the source countries to tax the retirement fund benefits. Under this provision, the residency country will either exempt the retirement fund benefit from tax if it was taxed in the source country or provide a tax credit for the tax paid on the retirement fund benefit paid to the source country (see sections 3.5.2.1 and 3.5.2.2).

South Africa and the other countries could conclude the double tax agreement to allow limited source taxation. Under this provision, both the residency and source countries will have the taxing

right on the retirement fund benefit. The source country will be able to tax the retirement fund benefit in terms of its own law, but the taxation will be subject to an agreed limit. The article addressing methods of eliminating double taxation would also need to be amended to include a provision requiring the country of residence to provide a tax credit for any taxes paid on the retirement fund benefit to the source country (see section 3.5.2.3).

The last alternative provision to sole residency taxing rights is for South Africa and the other countries to conclude the double tax agreement to allow the source country to tax the retirement fund benefit if the residency country does not tax the retirement fund benefit. If South Africa wants to use any of these alternative provisions discussed above, the double agreements will need to be renegotiated with the other countries (see section 3.5.2.4).

3.5.4 Summary of the OECD findings

The OECD developed the Model Tax Convention to address the differences in tax implications as more people became exposed to different countries' tax legislation. The Model Tax Convention provided uniform principles and rules that countries could follow or use to base their local tax legislation on. The OECD's Model Tax Convention prefers that retirement fund benefits' taxing rights should be allocated to the residency country. Many double tax agreements concluded by South Africa follows this view. However, other countries follow different tax systems on retirement fund benefits, which could result in tax policy mismatches when an individual emigrates or works in multiple countries. Therefore, the OECD offers an alternative to the residency country having the sole taxing rights on retirement fund benefits. These alternatives range from exclusive source taxing rights to limited source taxing rights.

3.6 Comparison of the tax implications between South Africa, the United States of America, and the OECD

Table 3-1 below provides an overview of the proposed tax implications on retirement funds of individuals ceasing their South African tax residency compared to the expatriate tax in the USA and the OECD's source allocation taxing rights on retirement funds.

Table 3-1: Comparison of the tax implications and proposed tax implications on retirement funds of individuals who cease their tax residency in South Africa, the USA, and the OECD

	South Africa	United States of America	OECD
Source of retirement funds	Country in which the services were performed that led to the retirement fund benefits.	Country in which the services were performed that led to the retirement fund benefits.	Countries that are party to the double tax agreement will agree on the source of retirement funds.
Taxing right on cross-border retirement funds benefits	Most double tax agreements are concluded to afford the residency country the taxing rights on retirement fund benefits.	Most double tax agreements are concluded to afford the residency country the taxing rights on retirement fund benefits.	- The OECD prefers that the residency country has tax rights on the retirement fund benefits. - The OECD does provide alternative provisions that allow source countries the taxing rights on retirement fund benefits. These provisions allow for either exclusive taxing rights or limited taxing rights.
Applicability of the exit tax provisions	Applicable to all individuals who cease their South African tax residency.	Applicable to individuals who relinquish their USA citizenship or green card and meet the requirements. Generally applicable to high-value individuals.	The OECD's Model Tax Convention merely provides a basis on which countries to base their double tax agreements. This assists in preventing tax evasion and tax

			avoidance and ensures the risk of double taxation is reduced.
Tax implications on emigration	• Under the proposed exit tax provisions, the individual will be deemed to have withdrawn their retirement fund benefit on the day before the individual ceased their South African residency. • The retirement fund benefit will be taxed as a withdrawal benefit using the withdrawal lump sum tax table. • The tax payment will be deferred until the fund receives the benefit. Interest will be charged on the outstanding tax liability.	• The individual will be deemed to have received a distribution from the retirement fund equal to the current value of the interest in the retirement fund the day before expatriation. • The deemed distribution will be taxed at the normal tax rates applicable to the individual. • For certain retirement funds, the individual may elect to defer the tax payment until the day the retirement fund benefits are received. This is subject to certain requirements being met. • If the individual elects to defer the tax payment, interest will be charged on the outstanding tax debt.	• The OECD's Model Tax Convention merely provides a basis for countries to base their double tax agreements. This assists in preventing tax evasion and tax avoidance and ensures that the risk of double taxation is reduced.

Tax implications when the retirement benefit is received	• Once the retirement fund benefit is received from the fund, it will be subject to tax again. The tax rate will depend on the circumstances that led to the benefit being received. If the benefit is withdrawn prior to retirement, the benefit will be subject to tax at the withdrawal lump sum rates. If the benefit is received due to retirement, it will be subject to tax at the retirement lump sum benefit rates.	• Once the retirement fund benefits are received from the fund, it will be subject to tax again at either the tax rates applicable to the individual or 30%, depending on the type of retirement fund.	• The OECD's Model Tax Convention merely provides a basis on which countries to base their double tax agreements. This assists in preventing tax evasion and tax avoidance and ensures the risk of double taxation is reduced.
Tax credits	• A tax credit will be provided for the tax calculated when the individual ceases to be a tax resident.	• To ensure that same benefit is not subject to tax twice, an appropriate adjustment will be made to account for the expatriation tax that was paid.	• The OECD's Model Tax Convention merely provides a basis on which countries to base their double tax agreements. This assists in preventing tax evasion and tax avoidance and ensures the risk of double taxation is reduced.
Double tax agreement implications	• Currently, most of South Africa's double tax agreements allow the source country to tax the retirement	• The USA has concluded most double tax agreements to grant the	• The OECD's Model Tax Convention merely provides a basis for countries to base their double tax

	fund benefit. Thus, the proposed exit will result in the retirement fund benefit being subject to double taxation.	residency country the taxing rights on retirement funds. • Most double tax agreements, however, include a clause that allows the USA to tax former residency as if the double tax agreement was not entered into. • The USA will provide a tax credit for tax paid on the retirement fund benefits in the source country.	agreements on. This assists in preventing tax evasion and tax avoidance and ensures the risk of double taxation is reduced.
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Source: Author's compilation

3.7 Conclusion

In this chapter, the secondary objective set out in section 1.5.2(ii) is to analyse the tax implications on retirement benefits of emigrating individuals in the USA and analyse international practices such as the OECD guidelines. This was achieved by analysing the source and taxing rights of retirement funds, taxation of retirement fund benefits in the USA, taxation of retirement fund benefits of individuals ceasing their USA residency, the OECD's Model Tax Convention view on taxing rights of retirement funds, and the allocation of taxing rights.

It was found that the USA has levied an exit tax on the retirement funds of individuals who cease their USA citizenship. The exit tax provisions in the USA do not differ significantly from the proposed exit tax in South Africa. The main difference identified was that the USA exit tax does not apply to all emigrating individuals. Secondly, the USA concludes double tax agreements to include a provision to tax former USA residents as if the double tax agreement had not been entered into. Furthermore, it was found that the OECD prefers that the residency country should have taxing rights on retirement fund benefits. However, the OECD provides alternative provisions that allow the source country to tax the retirement fund benefits either exclusively or partially.

The final chapter provides a summary of the information provided in the study, an overall conclusion to this study, and areas for future study.

CHAPTER 4 SUMMARY AND CONCLUSION

4.1 Summary

This mini-dissertation deals with the proposed exit tax on retirement funds of emigrating individuals in South Africa. Chapter 1 of the mini-dissertation introduced the topic by providing background information and a motivation for the actuality of the topic. The research was performed via a literature review of available sources. The following sources were used: the South African Tax Legislation, the USA Tax Legislation, Model Tax Conventions, double tax agreements, journal articles, and Internet articles.

Currently, South Africa does not tax retirement funds of emigrating individuals when they cease their South African tax residency. Once the former resident receives retirement fund benefits from a South African source, it might not be subject to South African tax. This is due to the provisions of certain double tax agreements, which grant exclusive taxing rights over retirement funds to the country of residence. As a result, South Africa has proposed introducing an exit tax on the retirement funds of individuals who cease their South African tax residency.

This led to the research question of this study: What is the potential taxation treatment of the exit tax on the retirement funds of emigrating individuals in South Africa, and what recommendations can be made towards anticipated legislation based on good practices followed by the USA and the OECD? The main and secondary objectives of this mini-dissertation were addressed in each of the chapters.

4.1.1 South Africa

Chapter 2 addressed the first secondary objective, which is to critically analyse the current tax implications on retirement funds of individuals who are emigrating and to critically analyse the potential tax implications of the proposal to introduce an exit tax to ensure that retirement benefits are taxed in South Africa when an individual emigrates. Thereafter, these two approaches will be compared.

This chapter started by providing a brief overview of the taxation of retirement funds in South Africa. This included exploring the components of the EET tax regime on retirement funds followed in South Africa. How retirement funds can be accessed was also explored. Other key considerations, such as South African tax residency, ceasing to be a South African tax resident, and the source of retirement funds, were also explored. Retirement fund benefits that arise from services rendered in South Africa are considered a South African source of income.

An analysis of the current tax implications on retirement funds of individuals ceasing their South African tax residency was performed. Certain retirement fund vehicles, such as preservation and retirement annuity funds, are subject to a three-year lock-in period. Individuals will only be able to access these funds once they have been a non-resident for a period of three years. However, pension and provident funds are not subject to the three-year lock-in period.

Once an individual receives a retirement fund benefit, it should be subject to tax in South Africa as it is from a South African source, and non-residents are taxed on South African source income. However, due to the provisions of certain double tax agreements entered into between South Africa and other countries, the taxing rights of the retirement funds are allocated to the residency country. In this case, South Africa loses its taxing rights on South African-sourced retirement fund benefits. This posed an issue, as individuals benefited from tax deductions on contributions to the retirement fund and tax-free growth on the retirement fund benefits. Furthermore, individuals who remain South African tax residents will be subject to tax on retirement fund benefits that they receive. Due to the above, the National Treasury proposed introducing an exit tax on retirement fund benefits of individuals who cease their South African tax residency. The current exit tax provisions in South Africa exclude retirement fund benefits.

The proposed exit tax was envisaged to be achieved by introducing a new section into the Act. The individual would have been deemed to have disposed of their retirement fund on the day before they ceased to be a South African resident. The deemed disposal would be treated as a withdrawal benefit and subject to tax using the withdrawal lump sum benefit tax rates. However, the tax will be deferred until the individual receives the retirement fund benefit. Once the retirement fund benefit is received, it will be subject to tax using the rates applicable to a retirement or withdrawal lump sum benefit. A tax credit will be provided for the tax calculated when the individual ceases to be a South African tax resident.

However, the proposed exit tax was withdrawn from the legislative cycle due to various concerns raised by the public. These concerns related to the potential double taxation that an individual could face and the double tax agreement override that would occur if the proposal was legislated in its current form. The proposed exit tax on retirement funds has not yet resurfaced since it was halted. The National Treasury, however, alluded to revising it after the public comments were taken into consideration. The above-mentioned South African tax implications were then compared to international best practices and the tax implications in the USA.

4.1.2 United States of America and international practises

Chapter 3 addressed the second secondary objective, which is to analyse the tax implications of retirement benefits for emigrating individuals in the USA and compare these with the potential tax implications of the proposed exit tax on retirement fund benefits in South Africa, as well with international practices such as the OECD guidelines. This was done to suggest improvements to the South African proposal to levy an exit tax on retirement funds.

The USA has different retirement systems in place. Some retirement funds are tax-deferred, while others are funded from already-taxed money. For comparison to South Africa, only tax-deferred retirement fund plans were considered. Under this retirement system, contributions to the retirement fund growth will be exempted from tax. Tax will only be levied on the retirement fund once the individual withdraws from the retirement fund. The USA views the source country of retirement fund benefits as the country where the services were rendered that led to the retirement fund benefits.

The USA has an exit tax in place, known as an expatriate tax. The expatriate tax only applies to high-value individuals who cease their USA residency. The individual who ceases their USA residency will be deemed to have disposed of their retirement fund interest on the day before they cease their residency. The deemed retirement fund distribution will be subject to tax at the normal rate applicable to the individual. No early withdrawal penalties will be applicable if the individual ceases their residency before retirement age. The individual may elect to defer the tax payment until the retirement fund benefit is received. This is only allowed if the retirement funds fall under the eligible deferred compensation category, the requirements are met, and the IRS approves the election. The deferred tax payment will be subject to tax from the date of expatriation until the tax debt is settled. Once the individual receives the retirement benefit, it will be subject to tax at a rate of 30%.

The USA taxes non-residents on USA source income. Therefore, once the non-resident receives the retirement fund benefit, it will be subject to tax based at the rates applicable to the individual. An adjustment for the retirement fund benefit will be taxed when the individual ceases their residency.

Part of the second secondary objective was to examine international best practices. The OECD's Model Tax Convention and the UN's Model Convention were considered. The OECD's Model Tax Convention is the most relied upon; therefore, more focus was placed on it. The UN's Model Convention prefers the view that the source country should tax the retirement fund benefits that were received by the residents of another country. On the other hand, the OECD's Model Tax

Convention prefers the view that the country of residency should have the taxing rights on retirement fund benefits received by a resident of that country. The OECD's Model Tax Convention offers alternatives to the sole taxing right belonging to the residency country.

4.2 Conclusion of findings

Under certain circumstances, when individuals cease their South African tax residency, South Africa loses their taxing right on retirement fund benefits. This is due to double tax agreements being concluded that allocate the sole taxing on retirement funds to the country of residency. Taxation of retirement fund benefits in South Africa follows the EET system, which only levies tax on retirement funds once the benefit is received. Therefore, the individual received tax deductions for contributions, the fund's growth was tax-exempt, and now, due to double tax agreements, South Africa does not have the right to tax the retirement fund benefit. The current exit tax provisions in South Africa do not apply to retirement fund benefits.

Due to the above, the National Treasury proposed introducing an exit tax on retirement fund benefits of individuals once they cease their South African tax residency. This led to the main objective of the study, which is to critically analyse the potential tax implications of the proposed exit tax on the retirement funds of emigrating individuals in South Africa, compare it to the tax laws of the USA, and examine international practices such as those of the OECD, to develop recommendations for South Africa's anticipated tax legislation. According to the proposed exit tax legislation, the individual would have been deemed to have withdrawn the retirement fund benefits on the day before tax residency ceased. The tax would be levied on that retirement fund benefit using the retirement withdrawal lump sum benefit tax table. However, the tax would be deferred until the individual receives the retirement fund benefit. At this stage, it would be subject to tax again using the prevailing retirement tax rates. A tax credit would be provided for the tax paid when the individual ceased their South African retirement fund benefit.

The above proposal was withdrawn from the legislative cycle due to concerns raised on various issues, such as double taxation and the override of the double taxation agreement. The National Treasury noted that the proposal would be reworked to address these comments and reintroduce it into a future legislative cycle. This has, however, not yet occurred.

The USA imposes an exit tax on individuals who renounce their USA citizenship. This exit tax is also applicable to retirement fund benefits. The individual is deemed to have withdrawn their retirement fund benefits the day before citizenship is renounced. In most cases, tax will be levied at the rates that apply to the individual. Once the individual receives the retirement fund benefit, it will be subject to USA tax again as it is viewed to be from a USA source. An adjustment will be

made to ensure that the retirement fund benefit that was taxed on expatriation will not be taxed again. The USA has concluded double tax agreements to include a clause allowing the USA to tax their former residency as if the double tax agreement was not in place.

The exit tax that is proposed in South Africa does not differ much from the exit tax that is in place in the USA. The main difference is that the exit tax in the USA is only applicable to high-value individuals. In contrast, the exit tax proposed in South Africa will apply to all individuals who cease their South African tax residency. The USA also allows certain retirement funds the retirement fund benefits that are received, subject to certain requirements being met. The South African proposal does not include such a provision. Conversely, the USA has concluded certain double tax agreements to allow for the taxation of former residency as if the double tax agreement was not entered into. On the other hand, the double tax agreements concluded by South Africa do not include such a saving clause.

The OECD's Model Tax convention allocates the taxing right on retirement funds to the residence country. Most South Africa's double tax agreements are concluded based on the residency country having the sole taxing right on retirement fund benefits. Therefore, if the proposed exit tax is enacted in its current form, it will go against this provision and lead to double taxation and a double tax agreement override. However, The OECD offers alternative provisions to the sole residence country that some countries follow. South Africa could consider renegotiating double tax agreements to include provisions allowing the source country to tax the retirement fund benefits. Provisions should also be considered to ensure that double taxation is eliminated.

Considering the above, the justification for the proposed tax on the retirement funds of individuals ceasing their residency - that South Africa loses its taxing rights in certain instances and that the individual benefited from exemptions on retirement fund contributions - was found to be valid. The proposed exit tax will lead to more tax revenue for South Africa. However, the risk of double taxation and a double tax agreement override is too significant to ignore. Therefore, for the proposed exit tax to work, South Africa would need to renegotiate the double tax agreements entered into with other countries to allow for exclusive or limited source taxation on retirement fund benefits.

Therefore, the above successfully answered the study's research question: What is the potential taxation treatment of the exit tax on the retirement funds of emigrating individuals in South Africa, and what recommendations can be made towards anticipated legislation based on good practices followed by the USA and the OECD?

4.3 Areas for future study

Due to the ever-changing nature of tax legislation, more studies can be performed on how South Africa compares to international taxation trends. A study could be performed on the role of double tax agreements on the current tax treatment in terms of local tax legislation. A more in-depth study could be performed on the impact of the three-year lock-in rule applicable to certain retirement vehicles. Further areas of study could also include analysing the Two-Pot Retirement System that came into effect in South Africa on 1 September 2024.

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