

A review of the residency definition for natural persons in the South African income tax regime

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ABSTRACT

In a multi-national world where traveling abroad and working across the globe is a very common occurrence, the question regarding one's residency status in each respective country becomes a crucial one. South Africa recently proposed an amendment to its Income Taxation Act, S10(1)(o), which would entail South Africans working abroad being taxed in South Africa on their income earned in other countries if this income is above R1 million.

This means that now, more than ever, an individual's residency status is important to ensure that he or she is rightfully taxed in the appropriate country and that non-compliance of the Income Taxation Act is prevented as far as possible. In addition, residency status ensures that uncertainties regarding our definition of residency are addressed and possible amendments in order to achieve this were researched.

In order to achieve this, the South African residency definition for natural persons were reviewed in this paper, and an international comparison were performed between South Africa and other countries in order to determine what South Africa could possibly change regarding their definition to ensure non-compliance is kept to a minimum.

KEY TERMS

Residency

Natural person

S10(1)(o) Amendment

Residence-based system

Double taxation agreement

Remuneration

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CHAPTER 1 INTRODUCTION

1.1 Background to the study

After the increase in global trade in the early 1920s, the League of Nations studied the issue of global double taxation, which started becoming an issue, affecting all businesses. One of the foremost objectives of the study was to formulate general principles, which would become the basis of an international tax framework that would help to prevent double taxation.

The outcome of this study was the concept of “economic allegiance”, which became the basis of design for an international tax framework. Certain factors aim to measure the existence and extent of economic relationships between a particular state and the income or person to be taxed. Economic allegiance is based on these factors and more specifically, the origin and situs of wealth or income, the enforcement of the rights to wealth or income and the place of residence or domicile of the person entitled to dispose of this wealth or income.

The study concluded that among those factors the greatest weight should be granted to the source of the wealth (origin) and the residence or domicile of the owner who consumes the wealth (residence). In conclusion, the League of Nations was of the opinion that tax jurisdiction should generally be allocated between the state of source and residence, depending on the nature of the income. This early principle of international taxation continues to be valid to date (Dhruva Advisors LLP, 2015:1).

The residence and source basis of taxation can be traced back to the period after World War I (1914-1919) when double taxation increased. The two systems of taxation could be categorized as the territorial basis of taxation and the worldwide basis of taxation. Under the territorial system of taxation, persons are taxed on income originating within the territorial or geographical confines of the country. This system draws lines between economic events that occur within a country and those that do not. The justification of this system is that a taxpayer should share the costs of running the country that makes it possible for this taxpayer to produce that income. The worldwide basis of taxation is an indirect method of assigning a tax base to a nation. Residents are taxed on their worldwide income regardless of the source. This basis of taxation ignores the factors

that gave rise to the income and focuses on the person who earns the income. This basis is justified by the fact that the taxpayer should contribute to the government cost of his country of residence since they can always return to their country and will always have the protection of the government wherever they are abroad. Nowhere in the world are either of these bases applied in their purest form. Many countries' policies fall somewhere in the middle (Cited by Oguttu, 2016:248).

The Appellate Division has contrasted the residence basis of taxation to a source-based system in the following terms (*Kerguelen Sealing & Whaling Co., Ltd v CIR*, 1939 AD 487, 10 SATC: 363):

"In some countries, residence (or domicile) is made the test of liability for the reason, presumably, that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters him. In others, the principle of liability adopted is 'source of income'; again, presumably, the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live. In both systems there is, of course, the assumption that the country adopting the one or the other has effective means to enforce the levy" (*Katz Commission*, 1997).

Up until 2001, South Africa applied a source-based system of taxation. All income that was from a source in South Africa and certain types of income that were deemed to be from a source in South Africa were taxable in South Africa. This meant that income that was not from a South African source, or deemed to be from a South African source, was not subject to tax in South Africa. As a result of this, section 10(1)(o) of the Act made an income tax exemption available only in respect of foreign employment income earned by officers and crew members employed on board any South African ship if those officers and crew members were outside South Africa for more than 183 days during the year of assessment (*Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2017:5), hereafter referred to as the Amendment Bill.

The Amendment Bill further explains that from 1 March 2001, South Africa moved to a residence-based system of taxation. This means that residents are taxed on their worldwide income. Therefore, the scope of the section 10(1)(o) exemption was amend-

ed to include South African residents who are outside South Africa for the purposes of rendering services for, or on behalf of, their employer for a period which, in aggregate, exceeds 183 full calendar days during any period of 12 months commencing or ending during a year of assessment. This exemption, however, does not apply for services rendered outside South Africa for or on behalf of any employer in the national, provincial or local sphere of government, or any public or municipal entity. Remuneration derived from holding of a public office to which that person was appointed, or deemed to be appointed under an act of Parliament, is also excluded from this exemption.

1.1.1 Reasons for amendment

As per the Amendment Bill, when the section 10(1)(o)(ii) exemption was introduced, the main purpose was to prevent double taxation of the same employment income between South Africa and the foreign country. This was supported by the fact that during that time, South Africa had a more limited number of Double Taxation Agreements (DTA's) to assist with the prevention of double taxation. The intention was never to create situations where employment income is neither taxed in South Africa, nor in the other foreign country. As a result, the explanatory memorandum on the Revenue Laws Amendment Act, 2000, anticipated the possibility of the abuse of this exemption and stated the following: "The effect of this relief measure will be monitored to determine whether certain categories of employees abuse it to earn foreign employment income without foreign taxation."

The Amendment Bill further highlights that:

- The current exemption creates opportunities for double non-taxation in cases where the foreign country does not impose income tax on the employment income, or taxes on this income are imposed at a significantly reduced rate.
- This exemption also creates unequal tax treatment between South African residents employed by a national, provincial or local sphere of government, or any public or municipal entity and South African residents employed by the private sector. This is because only employees in the private sector qualify for this exemption; employees employed by a national, provincial or local sphere of government, or any public or municipal entity, do not.

Deloitte also explained the proposed amendment as below:

“During a meeting held by Parliament’s Standing Committee for Finance, on 15 September 2017, National Treasury suggested certain changes to their original proposal, namely:

Section 10(1)(o)(ii) will no longer be repealed in totality but the first R1 million of foreign remuneration will remain exempt from tax in South Africa if the individual meets the requirements of Section 10(1)(o)(ii) in relation to the remuneration.

If the proposed changes are implemented, where a South African resident earns remuneration of more than R1 million as a result of services performed outside of SA, the portion of the foreign remuneration above R1 million will be included in the person’s South African taxable income and taxed at the applicable personal income tax rate, even if they comply with the requirements of S10(1)(o)(ii). This may lead to an increased South African tax liability for that individual, to the extent that they have not paid taxation on that remuneration in that foreign jurisdiction” (Deloitte, 2017).

Further implications regarding this amendment of Section 10(1)(o)(ii) is highlighted by the following Taxtalk article:

There is no provision for any adjustment for the cost of living overseas in comparison to South Africa and private expenses are not deductible for tax purposes. In addition, the income will not be able to be shielded by any applicable tax treaty between South Africa and the foreign country. This is because South Africa mainly follows the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention in its treaty articles, which affects employment income.

In terms of Article 15 of the Model, remuneration received by a South African resident in respect of employment services will only be taxable in South Africa. Therefore, the resident state has the primary right to levy tax on its residents. The only other time that the treaty country is also allowed to tax that remuneration is if the employment is exercised in that country. In that case, the resident state would then grant a tax credit or exemption in order to prevent double taxation.

Article 15 does not cover instances where the employment state does not impose tax, nor does it take away the right of the resident state to impose tax. It emphasizes the

right of the resident state to always be able to tax its residents and, if certain conditions are met, South Africa has the exclusive right to tax its residents (Makhola, 2017:42).

1.1.2 Relevance of the topic

Since there would be South Africans with professional degrees who would earn more than a R1 million abroad, the R1 million exclusion would not be a relief for everyone. This brings about the question, how will South Africans living and working abroad react to this change that could significantly impact their cash flow? The impact of the proposed amendment of the Section 10(1)(o) income tax exemption on foreign service income will possibly lead to South Africans living abroad, questioning their residency status and possibly even try to change their residency status to avoid paying taxation in South Africa. If South Africans living abroad can prove that they no longer qualify as South African residents, they will only be taxed on income from a South African source and no longer be taxed on the income received abroad.

A study done by Bezuidenhout, Joubert, Hiemstra and Struwig (2009), indicated that 51,7% of participating medical doctors claimed that the South African Income Tax system was one of the reasons why they chose to leave South Africa. 86,2% indicated financial reasons, which was also the main reason for leaving South Africa and working abroad.

Based on this study the paying of taxation in South Africa could influence highly skilled individuals to choose to no longer be residents. This could also lead to possible non-compliance of individuals with regards to our residency definition. If the decision is mainly financial, their net salary would have a big impact on their decision and therefore taxation would certainly play a part in the decision. Therefore, the relevance of the South African definition of 'Residency' should be researched. In considering the relevance of the definition, the residency definition of other countries will be reviewed to determine what South Africa could possibly learn from their definition and whether our definition is possibly too stringent and could potentially lead to non-compliance of taxpayers living abroad.

1.2 Problem statement and research question

The residency definition in the income tax act of South Africa could potentially be too inexact and ambiguous, and this could lead to potential non-compliance of South Africans working abroad. In light of the recent amendments of S10(1)(o) of the Income Tax Act, the question that arises is whether the definition of residency is still relevant in comparison to international taxation legislation?

1.3 Research objectives

1.3.1 Main Objective

To determine whether the South African definition of residency is still relevant in light of changes to the legislation (S10(1)(o) of the Income Tax Act) with regard to natural persons working abroad, and in comparison to international legislation or practice. The current definition could potentially lead to non-compliance.

1.3.2 Secondary Objectives

1.3.2.1 To consider the historical development of the residency and source taxation bases in order to understand the reasoning behind the development of the South African residency definition.

1.3.2.2 To analyse the South African residency definition as is, and to identify possible areas of non-compliance and uncertainty.

1.3.2.3 To do a comparison of the residency definition to other countries, and to consider what the Double Taxation Agreements specify regarding the residency definition.

1.4 Justification regarding countries used in international comparison

The discussion below reveals the motivation behind the choice of countries used in the comparison to South Africa.

1.4.1 China

The reasoning behind using China as a country to compare to South Africa is discussed below.

- **Classification of economy**

China is included, with South Africa, as one of the BRICS countries because their economy is considered to be one of the five major emerging national economies. Comparing our definition to another country with an emerging economy is one of the reasons why this would be a good comparison to South Africa.

- **Increase in tourists**

More and more foreigners find China an appealing country full of opportunities.

Travelers and international students, who are enchanted by its beautiful scenery, luring delicacies, safe environment, convenient transportation, prosperous economy and friendly people, would rather stay and work in China than return home.

Statistics from the China National Tourism Administration proved that the number of inbound tourists exceeded outbound tourists in the first half of 2017, reaching 65.1 million, which represents a year-on-year increase of 4.5 percent. The number of foreigners with permanent resident status also increased by 163 percent from 2015 to 2016 (People's daily online, 2017).

This is another reason to compare our residency definition to China, due to the increase in foreigners who want to make China their permanent residence. Their residence definition would need to be comprehensive enough in order to tax all these foreigners moving to China.

- **Emigration of residents**

When considering which countries have the most native-born people living abroad, China is one of the countries with the least number of their nationals living abroad. In 2014, only 0,3% of the country's residents were living abroad (McCarthy, 2016). Therefore, it seems that most of their residents want to stay in their country and are not looking to pay less tax somewhere else, which is another reason for comparing our residency definition to theirs since the ideal would also be for our qualified citizens to stay in South Africa and grow our own economy.

1.4.2 Switzerland

The reasoning behind using Switzerland as a country to compare to South Africa is discussed below.

- **Basis of taxation**

Individuals who are Swiss residents, are taxed on their worldwide income and wealth, and non-residents are only taxed on Swiss-sourced income and wealth (MME, year). Since this is the same residency basis of taxation that South Africa uses, the comparison would be suitable.

- **Additional ways of taxing non-residents**

Foreign national residents in Switzerland who are not gainfully employed, can choose to be taxed on a lump-sum basis. This taxation is based on the taxpayer's actual annual living expenses; therefore, the tax is calculated on the total annual cost of living expended by the taxpayer in Switzerland and abroad, for him/herself and the dependents living in Switzerland. The law, however, specifies that an additional minimum calculation has to be done, which demands that the tax may not be lower than the tax on specified gross elements of income and wealth according to the regular tax in Switzerland. It includes all income from Swiss sources and income for which the taxpayer claims relief from foreign taxation in terms of a double taxation agreement with the other foreign country (MME, not dated).

This lump sum taxation system where foreigners are taxed according to their spending habits, has now made the country a popular destination for French sport stars and artists (Jaberg, 2014).

This concept of paying taxation only on your expenditure, which results in less taxation than a person would pay in their native country, causes high net worth individuals to become residents of Switzerland. Since this is a unique way of taxing high net worth individuals and one of the reasons individuals want to become residents of Switzerland it was considered that Switzerland could be a country that South Africa could possibly benefit from learning from.

- **Advantages for residents**

The Organization for Economic Cooperation and Development (OECD) Taxing Wages 2017 report measures the level of personal income taxation and social security contributions in each OECD country by calculating the “tax wedge”—personal income taxation, employer and employee social security contributions, minus family benefits received as a proportion of total employer labour costs. Even though European nations are known for having the highest tax rates for both individuals and families, there are a few low-tax European countries.

Countries with tax wedges for single childless workers that fall below the OECD average of 36% include: Poland at 35.8%; the UK at 30.8%; Ireland at 27.1% and Switzerland at 21.8%. Therefore, Switzerland falls within the world economic forum’s top 10 countries where workers pay the least taxation (World Economic Forum, 2017).

The above two reasonings make it clear that Switzerland has taxation advantages for both the average worker as well as the high net worth individual.

- **Classification of economy**

Switzerland is the number one most competitive global economy in the world economic forum global competitiveness report 2017-2018, making it a country South Africa can certainly benefit in learning from.

- **Emigration of residents**

When considering the countries with the most native-born people living abroad, Switzerland is among the top ten countries with the most nationals living abroad. In 2014, 7,4% of the resident population were living abroad (McCarthy, 2016). This also means their residency definition needs to cater for the Swiss residents living abroad, the same way South Africa’s definition needs to cater for South Africans living abroad.

1.4.3 India

Discussed below is the reasoning behind using India as a country with which to compare South Africa.

- **Basis of taxation**

Individuals in India are taxed based on their residential status. India differentiates between residents who are ordinarily a resident and those who are not ordinarily a resident. This then determines on which income they would be taxed (PWC, 2018). In principle, India also follows the resident basis of taxation like South Africa and a comparison would thus be possible. It is also worthwhile to investigate the two further specific classifications of their residency definition to determine what South Africa can learn from this.

- **Emigration of residents**

Between 2010 and 2015, India was one of the countries with the highest levels of net immigration (United Nations, 2017). In 2015, India had the largest number of nationals living abroad in the world (16 million), followed by Mexico (12 million) (United Nations, 2015). Since India has many residents living in other countries, the comparison to South Africa, which also has a lot of residents living abroad would make sense.

- **Classification of economy**

India is included, with South Africa, as one of the BRICS countries because their economy is considered one of the five major emerging national economies. This is one of the reasons why this would be a good comparison to South Africa, by comparing our definition to another country with an emerging economy.

1.4.4 United Kingdom (UK)

Discussed below is the reasoning behind using the UK as a country with which to compare South Africa.

- **Change in residency definition**

All South African expats working in the UK have been significantly impacted upon since the UK changed their residency definition in 2013. The new test considers three different aspects to determine residency. The statutory residence test (SRT) aims to remove any grey areas when determining someone's residence status for tax purposes in the UK (Featherby, 2013:8). A comparison to the UK would therefore, be advantageous in order to determine how their residency definition changed and what South Africa can learn from this.

- **Basis of taxation**

UK follows the resident-based tax approach. Non-residents only pay tax on their income from a UK source; they are therefore, not taxed on foreign sourced income. Residents normally pay UK tax on their worldwide income, this would include income from the UK and abroad. Since SA has the same basis of taxation (residency basis), a comparison to the UK is possible.

The UK government emphasises that there are, however, special rules for UK residents whose permanent home ('domicile') is abroad (gov.uk, not dated).

- **Classification of economy**

The United Kingdom was under the world's ten biggest economies in 2017 (World Economic Forum, 2017). Since they are one of the major economies in the world, it would be worthwhile to compare South Africa's definition to theirs.

1.5 Research method

Positivism is a controlled and structural approach in conducting research by identifying a clear research topic, constructing appropriate hypotheses and adopting a suitable research methodology (Edirisingha, 2012).

There are different types of law research available. For this study the focus will be on the following two:

Explanatory (This entails explaining the law, for instance by diverging historical backgrounds in comparative research. It is also defined as an attempt to connect ideas to understand cause and effect); and

Exploring (This entails looking for new, possibly fruitful paths in legal research. The aim is also to provide insights into an understanding of the problem faced by the researcher .) (Van Hoecke, 2011: *preface*).

Hutchinson and Duncan (2012) defines Reform-oriented research — 'Research which intensively evaluates the adequacy of existing rules and which recommends changes to any rules found wanting.' This adequately described this study's approach of considering the "residency" definition and establishing how this definition could be improved.

As the names suggest, quantitative research produces numerical data, whereas, qualitative research generates non-numerical data (MSG team, 2015). For this study, qualitative research will be performed in order to answer the specific research question.

“A literature review is an account of what has been published on a topic by accredited scholars and researchers. In writing the literature review, the purpose is to convey what knowledge and ideas have been established on a topic, and what their strengths and weaknesses are” (University of Toronto, 2018). A literature review entails that one learns what was done by others, and then builds and expands on that knowledge. A literature review should increase the credibility of the research and stimulate new ideas for further research (Newman, 2006:110).

Due to the nature of this research topic, a literature review would be the best way of conducting research, since a comparison between countries and their Residency definition would be done and the South African literature on the topic would be reviewed.

The method of data collection will consist of the review of secondary data.

Secondary data is the data that has already been collected and is readily available from other sources (MSG Team, 2015).

The study will be researched through the reviewing of available and relevant literature on the chosen subject. Sources that will be accessed during the review would include but not be limited to: South African and International legislation and regulation, Taxation summaries and comment of reputable professional firms, taxation articles and published academic papers.

Since there is a specific research question that needs to be answered, this method of research would be the most suitable. In order to answer the research question and come to a conclusion, a systematic analysis of the current South African Income tax Legislation would be performed and comparisons to the UK, Swiss, Chinese and Indian legislation and regulations would assist in achieving a conclusion as to the relevance and appropriateness of the South African residency definition.

1.6 Overview of chapters

Chapter 1 Introduction and background of research

This chapter focused on the introduction to the study to be conducted, as well as the motivation for the chosen topic. It focused on the background of S10(1)(o) of the Income Tax Act and how this influences my decision to research the residency definition for natural persons in South Africa.

Chapter 2 The history and development of the source and residency bases of taxation

This chapter will address the first secondary objective.

It will also focus on the history of the different bases of taxation and what South Africa's motivation was behind changing from a source basis of taxation, to a residency basis of taxation. The advantages and disadvantages of a residency basis of taxation will be considered.

Chapter 3 The current residency definition of South Africa for natural persons

This chapter will address the second secondary objective.

The South African residency definition for natural persons will be analysed and researched, in order to identify possible areas of uncertainty and possible areas of non-compliance. Court cases on the topic will be examined and other resources will be consulted to address this objective.

Chapter 4 Comparative analysis to other countries, also considering the DTA's and identifying possible improvements

This chapter will address the third secondary objective.

This chapter will compare the South African residency definition for natural persons to other applicable countries selected in order to determine possible improvements to our definition. The DTA's will also be examined in order to determine any uncertainties and to shed further light on the comparison between countries.

Chapter 5 Conclusion and suggestions for possible improvements to the definition

In this chapter, a conclusion will be reached on how South Africa's residency definition could possibly be improved and which areas of our definition could possibly lead to non-compliance of taxpayers living abroad.

CHAPTER 2 THE HISTORY AND DEVELOPMENT OF THE SOURCE AND RESIDENCY BASES OF TAXATION

2.1 Secondary objective addressed

To consider the historical development of the residency and source taxation bases in order to understand the reasoning behind the development of the South African residency definition.

2.2 Historical development of source and residency taxation bases in general

As discussed under the background to this study, the reason why source and residency basis of taxation developed was to address double taxation; this process started around the 1920's.

The justification of both these bases of taxation was addressed under the following court case:

"The basic rationale of a residence basis of taxation has been contrasted to that of a source-based system in the following terms by the Appellate Division (*Kerguelen Sealing & Whaling Co., Ltd v CIR*, 1939 AD 487, 10 SATC: 363):

"In some countries, residence (or domicile) is made the test of liability for the reason, presumably, that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters him. In others the principle of liability adopted is 'source of income'; again, presumably, the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live. In both systems there is, of course, the assumption that the country adopting the one or the other has effective means to enforce the levy" (*Katz Commission*, 1997).

The Katz report further highlighted that as trade and investment became more sophisticated and developed an international character, nations had to differentiate between two principles by which to levy tax on international income generated. These two principles are known as the residence or source principle of taxation.

The residence principle of taxation focuses on the taxation of all income derived by its residents, regardless of the source of income.

Tax authorities justify this approach because residents are protected by the state, and therefore, should contribute to the cost of maintaining their resident country's government, even though the tax would be raised on income earned in another state.

On the other hand, the source principle of taxation is based on the fact that regardless of residence, any person deriving income within a state's jurisdiction should contribute to the cost of financially maintaining that state. This principle, however, also underlines the fact that residents are expected to contribute towards the costs of the state.

It must be remembered that in an ever-changing and complex world of international trade, none of these principles can be applied in pure form, these principles have evolved to establish a common middle ground. Countries who have adopted a residency-based system, have made the compromise of taxing residents of other countries on an element of the source principle, if these individuals derive their income from within the domestic economy. Developed and net capital exporting countries usually adopt a residence-based system. Under the source-based system, residents who received a broad range of income (especially passive type income) are deemed to be from a domestic source and, therefore, taxable, irrespective of where the origin of the income lies.

("Passive" income is typically investment income such as interest or royalties, while "active" income derives from active trade or commerce.)

With the expansion of international trade, double taxation treaties were concluded between countries in order to prevent the same income being taxed twice between two jurisdictions. Many countries also provide relief against such double taxation in their national law, since double taxation would certainly significantly reduce international trade and investment.

The country of source will usually be given preference, whether provided for in national law or treaties. Where the country of residence and the country of source both want to tax the same income, the resident country would typically be expected to grant relief against its own tax. This would be achieved by either an exemption of the income, a de-

duction of foreign tax, or a credit for the source country's tax against its own tax (Katz Commission, 1997).

2.3 Historical development of source and residency taxation bases in South Africa

The initial income taxation laws in South Africa came from the principle that only income that was sourced in the Union would be taken into account when calculating taxation payable. Subsequently, the advisability of that system has been investigated (Katz Commission, 1997).

One of the first committees who were tasked with this goal was the Steyn Committee in 1951. This Committee made the recommendation to retain the source bases of taxation. Their decision was based on the fact that the change to a residence system of taxation would be very complex and they did not foresee a material impact on revenue (Steyn Committee, 1951).

In 1970, the Franzsen Commission made the opposite recommendation to the Steyn Committee. This commission was of the opinion that an increase in income was flowing to South Africa without being taxed. Since South Africa's major trading partners based their taxation system on a worldwide basis, the individual's ability to pay was increased. They were also of the opinion that South Africa had already deviated from a pure source basis of taxation due to various deeming provisions being introduced. Even though the Government accepted their recommendations in a subsequent White Paper, subject to further studies, the proposed change to a worldwide system was never pursued (The Franzsen Commission, 1970).

After the Franzsen Commission report, the Margo Commission was the next commission to review the issue in 1986/1987. This commission recommended that the source basis should be retained and the source-deemed provisions, which existed then, could possibly be extended. This commission highlighted two reasons, which would support the residence basis of taxation. The first reason had to do with exchange controls; if they were lifted, a worldwide basis would be important to help curb tax avoidance.

The second reason was the fact that the worldwide system would counter the schemes of avoidance, which was exposed by the “independent national states” existing at that time.

This commission also noted considerations in favour of retaining the source basis of taxation. The first reason was the fact that legislation for, and the administration of a worldwide system, would be more complex than a source system of taxation. The second reason had to do with the fact that due to the failure of a source system to tax income inflow from offshore, South Africa would have to grant credit for foreign taxes already paid. The third reason was the fact that fiscal benefits derived from a worldwide basis would be reduced when the South African tax rates were reduced. This commission then concluded that the disruption, which would be caused by a change to a residence-based taxation system, would not be justified by the possible benefits (The Margo Commission, 1987).

One of the reasons that led to the conclusion of the Katz Commission to keep the source basis of taxation was the following:

“It is vital for economic growth that the national financial and human/skills capital be maintained. This means that we must avoid policies that encourage their emigration. If South Africa were to tax all foreign income of South African multi-nationals, including income from their active operations abroad, and do so at the present relatively high rates, South Africa may lose many of these multinationals through emigration to more beneficial tax environments” (Katz Commission, 1997).

Subsequently, the change only happened in the year 2001 as mentioned below.

“The second phase of reform, started from 2000 onwards, focusing on the broadening of the tax base and adapting the tax system to conform to international tax law. The most fundamental change in income tax policy was the change from a "source-based" to a "residence-based" system in 2001. This was intended to protect and broaden the tax base and provide the South African income tax system with a flavour that conforms to international standards and practices” (Nyamongo & Schoeman, 2007:481).

“As was announced in the Budget Review, a ‘residence minus’ system will be adopted, with effect from years of assessment commencing from 1 January 2001. Residents will

be taxed on their worldwide income, but certain categories of income and activities undertaken outside South Africa will be exempt from South African tax. Foreign taxes paid by these residents will, however, be allowed as a credit against the South African tax liability.

The most important reasons for changing to the new basis of taxation are:

- to place the income tax system on a sounder footing, thereby protecting the South African tax base from exploitation;
- to bring the South African tax system more in line with international tax principles;
- the relaxation of exchange control and the greater involvement of South African companies offshore.
- to more effectively cater for the taxation of e-commerce” (SARS, 2000).

In practice, tax systems contain elements of both regimes. The South African tax system is currently based on the source principle. In 1997, provisions were introduced into the Income Tax Act, which deems some categories of foreign income to be from a South African source. These are primarily investment income in the form of annuities, interest, rental income, royalties or income of a similar nature.

The current basis of taxation provides opportunities for tax planning and avoidance, as taxpayers seek to reclassify as untaxed foreign-source income, income that would normally be taxed in South Africa. This is facilitated by the increasing globalization of the economy and the relaxation of exchange controls, which provide considerable scope for taxpayers to avoid South African tax by conducting business and providing services in low or zero tax rate countries. The generous tax holiday schemes in some countries in the region, add to the leakage.

It was proposed to move to a residence-based income tax for South African residents for years of assessment commencing on or after 1 January 2001. This would significantly broaden South Africa’s income tax base, limit opportunities for tax arbitrage and bring the tax system in line with generally accepted norms for taxing international transactions (Treasury, 2000).

2.4 Conclusion of chapter

The main reasoning behind changing to a worldwide basis of taxation was to bring South Africa more in line with international tax principles, to protect the tax base from exploitation and broaden the tax base. It is clear that the source basis of taxation, as well as the resident basis of taxation, is never applied in a pure form. This change brought about the increase in importance of our residency definition.

Therefore, the question now remains whether the residency definition is too stringent and could this potentially lead to non-compliance? Too stringent meaning that residents who have been living in other countries for a significant amount of time could still be considered South African residents when regarding the “ordinarily resident” definition. This could lead to individuals either emigrating due to the new S10(1)(o) amendment, or simply not comply to the South African tax residency rules by not submitting tax returns.

Another point that needs attention is the fact that South Africa aims to be more in line with international tax principles and standards, therefore, a comparison of our residency definition to international standards is a necessary exercise to ensure that this definition is in line with what the rest of the world is doing.

CHAPTER 3 THE CURRENT RESIDENCY DEFINITION OF SOUTH AFRICA FOR NATURAL PERSONS

3.1 Secondary objective addressed

To analyse the South African residency definition as it is and to identify possible areas of non-compliance and uncertainty.

3.2 South African Residency definition

The definition of a resident for a natural person can be found in Section 1 of the Income Tax Act No.58 of 1962:

“resident” means any—

(a) natural person who is—

(i) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—

(aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment, in which case that person will be a resident with effect from the first day of that relevant year of assessment:

Provided that—

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a “port of entry” as contemplated in section 9(1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and

(B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such

person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation” (Income Tax Act, 1962).

This basically means that a natural person would qualify as a resident for tax purposes if he/she is either ordinarily a resident or if he/she qualifies as a resident in terms of the physical presence test. The first test is always to determine whether a person is “ordinarily resident” and if a person does not qualify as “ordinarily resident”, the second test would apply, which would be the physical presence test. However, it is important to note that a person would be expressly excluded from the “resident” definition, if the person is deemed to be exclusively a resident of another country in terms of the double taxation agreement (DTA). Therefore, even if he qualifies as a resident in terms of the “ordinarily resident” definition or physical presence test, the DTA would take preference above these two tests (Lewis, 1999:258).

Any individual taxpayer who travels abroad on a frequent basis and works in more than one country, will have difficulty in determining their ordinary residence status, since this place of ordinary residence can change. Determining the residence of a taxpayer is therefore, one of the most critical aspects of a modern tax system (Arendse, Renaud & Stark, 2015). Since the term “ordinarily resident” is not defined in the act, court cases need to be considered to get a better explanation of the term.

3.3 Ordinarily resident

The two main court cases used in South Africa to get a better understanding of the definition of “ordinarily resident” are:

Commissioner for inland revenue v Kuttel [1992] 2 All SA 151 (A) and

Cohen v Commissioner for inland revenue 13 SATC 362

The CIR v Kuttel court case is considered below:

Goldstone JA in CIR v Kuttel determined the following:

“In *R v Barnet London Borough Council, ex parte Shah* and other appeals [1982] 1 All ER 698 (CA), Lord Denning MR (at 704 cd) said that the natural and ordinary meaning of “ordinarily resident” was “that the person must be habitually and normally resident here, apart from temporary or occasional absences of long or short duration”.

That view of the natural and ordinary meaning of the words was approved by the House of Lords on appeal: *Shah v Barnet London Borough Council and other appeals* [1983]

I agree with Lord Denning MR that in their natural and ordinary meaning, the words mean ‘that the person must be habitually and normally resident here, apart from temporary or occasional absences of long or short duration’. The significance of the adverb ‘habitually’ is that it recalls two necessary features mentioned by Lord Sumner in Lysaght’s case, namely residence adopted voluntarily and for settled purposes.”

Goldstone JA also stated that: “it is clear that a person may have more than one residence at any one time. In the present case, we are concerned with the words ‘ordinarily resident’. [Ordinary residence] is something different and, in my opinion, narrower than just ‘resident’.”

Goldstone also agreed with Schreiner JA’s view in the *Cohen v CIR* case:

“But his ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings, as contrasted with other lands it might be called his usual or principal residence and it would be described more aptly than other countries as his real home.”

Schreiner JA also had the view that “If, though a man may be ‘resident’ in more than one country at a time, he can only be ‘ordinarily resident’ in one, it would be natural to interpret ‘ordinarily’ by reference to the country of his most fixed or settled residence.”

He further contended that, “As already indicated, the annual character of the tax, while it refers the question whether the appellant was ordinarily resident within the Union to the tax year, does not exclude the investigation of his mode of life before, or even after, that year in order to arrive at a conclusion.”

From the above court cases, we can conclude that a person’s physical presence is not a requirement for “ordinarily resident”. A person can only be an “ordinary resident” in one country at a time, which would be his most fixed and settled residence. It is the

place where a person is normally/habitually resident and would return to from his wanderings.

Schreiner also emphasized the fact that one cannot purely consider the current year under review and that the taxpayer's mode of life before and after the year under review needs to be considered. It is exactly here where there is an uncertainty involved. There is no clarity in the act as to when exactly a person ceases to be an ordinary resident. There is no time-based rule that provides certainty as to the end-point of ordinary residence status for outward-bound expatriates (Arendse, Renaud & Stark, 2015). There is also nothing in the act that stipulates that a person remains an ordinary resident until he or she requires a new place of ordinary residence (Olivier, 2001).

As determined in the court case *Jean Maurice Laurin V Her Majesty the Queen*, where a person is previously "ordinarily resident" in one country, he or she will only be regarded as "ordinarily resident" of another country if they are able to demonstrate that ties were severed with the original country of residence (Lewis, 1999:260).

At birth, every person acquires a domicile by operation of law, this is also referred to as domicile of origin. This domicile is usually retained throughout a person's life, unless there is proof of a positive and permanent change of intention. Unlike domicile, one does not retain your ordinary residence in South Africa until it is taken up in another country. This practically means that a person can cease being an ordinary resident in South Africa and only after some time acquire ordinary residence in another country.

Many countries that use the ordinarily residence test have a statutory time test to determine at what stage a person will become ordinarily resident in such a country. This also means that a person could be physically present in South Africa for many years without being classified an ordinarily resident, since the physical presence test only applies if a person is not ordinarily resident in South Africa. It is, therefore, clear that the taxpayer's intention is more important than the duration of his or her physical presence in South Africa in order to determine the "ordinarily resident" status (Olivier & Honiball, 2011:51).

It is important to note that the term “residence” has particular meaning for tax law purposes and should not be confused with other terms such as “nationality/citizenship”; this term does not necessarily coincide with exchange control residence (Olivier & Honiball, 2011:19).

These principles were further discussed in the SARS interpretation note 3:

This interpretation note emphasizes that there is no specific list of factors to consider and each case needs to be examined on its own. It is also made clear in this note that a person does not have to be physically present in South Africa to be regarded a resident.

The purpose, nature and intention of a natural person’s absence must be established and considered as part of all the other factors mentioned below to determine whether a person is “ordinarily resident”. It is important to determine a person’s intention to become an ordinary resident, as well as consider whether any steps indicative of this intention, have been carried out.

This interpretation note mentions the following factors that need to be taken into account when assessing whether a person is “ordinarily resident”:

- The person’s intention to be “ordinarily resident” and his most fixed and settled place of residence.
- The place where the person stays most often and his or her present habits and mode of life.
- The person’s nationality, location of personal belongings, family, social relations and political, cultural and other activities will also be taken into account.
- It is also important to consider his place of business and application for permanent residence or citizenship.

In determining “ordinarily resident”, the periods abroad, frequency and reasons for visits and the status of the person in the republic and other countries, will also be considered (SARS, 2018).

It is clear from the above that “ordinary resident” is a term that is not adequately defined and most certainly a complex area since this would depend on each individual case and the specific circumstances surrounding a person. A person’s intention would have to be established, which is always a difficult thing to do.

3.4 Physical presence test

The physical presence test will only be applied if a natural person was not ordinarily a resident at any time during the relevant year of assessment. The physical presence test entails a person to be physically present in South Africa:

- For more than 91 days during the relevant year of assessment, as well as
- More than 91 days during each of the preceding five years of assessment; and
- More than 915 days in aggregate during those five preceding years of assessment.

This physical presence test is a clear and objective statutory test of residence as far as inward-bound expatriates are concerned (Arendse, Renaud & Stark, 2015).

Prior to 1 March 2006, only a four-year period was considered under the physical presence test. A natural person was a South African resident if he or she was physically present in South Africa for 92 days during the current and the three preceding years of assessment and 549 days in aggregate during those 3 preceding years. The legislature's intention in extending the period for exclusion from three years to the current five-year rule, was to attract foreign skilled employees to take up temporary employment in South Africa (Olivier & Honiball, 2011:23).

If the person is physically present in South Africa for 91 days or less in any of these six years, the chain is broken, which would entail that he avoids becoming a resident, and therefore, avoids being liable for tax on his worldwide income in South Africa. The six-year cycle would then commence from the first subsequent tax year in which the non-resident is physically present in South Africa for the required period (Lewis, 1999:260).

This could easily lead to non-compliance of the residency definition, especially with regard to South Africans who return to South Africa after working abroad. If these people are still considered to not be ordinary residents, they could easily just ensure their absence for more than 91 days in one year out of the 6 years and so ensure that they do not fall within the physical presence test requirements for residency. Since one year of non-compliance of the physical presence test would lead to the chain being broken and the six year cycle would start again. Especially since, as previously mentioned, there is no statutory time test with regard to the "ordinarily resident" definition.

In terms of the SARS Interpretation note 4:

This test, also known as the “day test” or “time rule”, takes into account the number of days that a natural person is physically present in South Africa.

The purpose or nature of the visit is irrelevant.

On an annual basis it must be determined whether all the requirements of the physical presence test have been met.

The effect of the definition of a “resident” is that a natural person who is not ordinarily resident in South Africa can only become a resident for tax purposes in the year after a period of five consecutive years of assessment, during which the person is physically present in South Africa for the periods as stipulated in the physical presence test.

A person will only be a resident with effect from the first day of the sixth year, during which all the requirements of the physical presence test have been met.

A person who ceases to be a resident during a year of assessment, then returns to South Africa during the following year of assessment and again meets the requirements of the physical presence test in that following year, will once again be resident as from the first day of that following year of assessment in which the requirements for the physical presence test are met.

A natural person, who is resident by virtue of the physical presence test, ceases to be a resident when that person is physically outside South Africa for a continuous period of at least 330 full days. Residence will cease from the day that the person left South Africa. The continuous period of 330 full days cannot be observed over a single year of assessment, because the person must have been physically present in South Africa for at least 92 days during that year in order to qualify as a resident during that year of assessment. The continuous period of at least 330 full days will, therefore, always extend over two years of assessment (SARS, 2018).

3.5 Applying the double taxation agreement

The third part of the residency definition is the part where a double taxation agreement could deem a person to be a resident of another country exclusively and that would ex-

clude a person from being a South African resident. This amendment was done in 2003 in an attempt to bring the South African domestic tax principles in line with international tax principles (Olivier & Honiball, 2011:24).

In most cases, a natural person will trigger tax residency in a country after being physically present in that country for more than 183 days in a tax year or when arriving in that country to activate a particular type of visa or residence permit. This practically means that an outbound natural person may remain an ordinarily resident in South Africa, and could at the same time be regarded as a resident of another country under the rules of that country. When this is the case, the natural person should investigate whether South Africa has a double taxation agreement in place with that specific country. If there is such a double taxation agreement in place, the tiebreaker provisions of the double taxation agreement need to be applied. This is normally article 4 of a double taxation agreement.

In applying this clause, a natural person could determine that he or she is exclusively a tax resident of the other country, which means he or she will be excluded from the South African residency definition even if they meet the other requirements of the residency definition. Most double taxation agreements that South Africa is party to, expressly require that tax residency in both states should be linked to some physical attachment to a country and not just be based on the taxability in that country due to income from a source in that country.

However, in some double taxation agreements; for a person to be regarded as a South African tax resident under that specific double taxation agreement, he or she needs to be ordinarily resident in South Africa. This would mean that a natural person who is a resident of South Africa by way of the physical presence test, cannot be regarded as exclusively a South African tax resident.

When applying a double taxation agreement and interpreting the wording, South Africa follows the guidance of the Commentary to the Model Convention of the Organization for Economic Co-operation and Development (OECD). Even though South Africa is not a member of the OECD, we prescribe to their interpretation and guidelines when it comes to double taxation agreements (SAICA, 2018).

3.6 Misapplying the double taxation agreements

There are two instances where persons could misapply the double taxation agreement. Firstly it would be to not give adequate consideration to the particular taxes covered by the specific double taxation agreement. Secondly the practical problem brought about by the mutual agreement procedure. Both these instances are discussed below.

It is important not to have a misconception with regards to the applicability of the residency rules of a double taxation agreement in relation to a South African living abroad and his or her tax obligations, where he or she continues to be an “ordinarily resident” of South Africa.

At the beginning of a double tax agreement, the agreement would state which particular taxes are covered and addressed by the agreement.

The exclusion to the residency definition in terms of a particular double taxation agreement only applies where and to the extent that a particular tax is covered by the double taxation agreement to prevent double taxation. Therefore, if a South African living abroad still considers South Africa the place to which they will ultimately return, they should not rely on the relief of an applicable double taxation agreement, since they are still exposed to various South African tax consequences, especially if the country in which they are temporarily residing does not expose them to the same taxes that they are exposed to in South Africa (Korten, 2011).

In terms of article 4 of the OECD guideline:

The term “resident of a contracting state” should be interpreted as any person who, under the laws of that country (state), is liable for tax by reason of his domicile, residence, place of management or any other criteria of a similar nature. State also includes any political subdivision or local authority thereof, as well as a recognized pension fund of that state. The term, however, does not include any person liable for tax in respect only of income from sources in that state or capital situated therein.

When a person is a resident of both contracting states (for example South Africa and another country), then the following steps should be followed to determine his status:

1. He/she will be deemed a resident only of the country (state) in which he has a permanent home. If he/she has a permanent home in both states, he/she will be

deemed a resident only of the country with which his personal and economic relations are closer. This is also called his centre of vital interests.

2. If the country in which he/she has his centre of vital interests cannot be determined, or if he does not have a permanent home somewhere, he will be deemed to be a resident only of the country in which he has an habitual abode.
3. If the person has an habitual abode in both countries or in neither of them, he will be deemed to be a resident only of the country of which he is a national.
4. If he/she is a national of both countries or neither of them, the competent authorities of the two countries shall settle the question by mutual agreement (OECD, 2017).

The use of this mutual agreement procedure poses a big practical problem for tax payers, since they must apply to the competent authority of the State of which they are a resident (Olivier & Honiball, 2011:36).

3.7 Conclusion

The South African residency definition was analysed and the following uncertainties were identified:

- The term “ordinarily resident” is not adequately defined, since one needs to rely on the intention of a taxpayer and a variety of other factors surrounding his specific circumstances in order to determine his “ordinarily residence” status.
- There is no specific time-line or time-based rule, which could be used to determine at what stage a natural person is “ordinarily resident” and when a person ceases to be an “ordinarily resident”.
- One year of non-compliance of the physical presence test requirement would lead to the chain being broken and the six-year cycle would start again. This could lead to non-compliance, since natural persons who do not qualify as ordinary residents could ensure that they are not physically present in the country for more than 91 days after five years, and the six-year cycle would have to start again.
- South Africa does not have double taxation agreements with all the countries and this could lead to natural persons being recognized as residents in two countries and subsequent double taxation.
- The mutual agreement procedure is not practical since one needs to apply to the relevant authorities in the country where one is a resident.

CHAPTER 4 COMPARATIVE ANALYSIS TO OTHER COUNTRIES, ALSO CONSIDERING THE DTA'S AND IDENTIFYING POSSIBLE IMPROVEMENTS

4.1 Secondary objective addressed

To do a comparison between South Africa's and other countries' residency definition, and to consider what the DTA's specify regarding the residency definition.

4.2 China

A comparative discussion between South Africa and China's residency definition is discussed below.

4.2.1 Residency definition of China

Individuals who have domicile in China, or if an individual does not have domicile in China but has resided for one year (365 days) or more in China, are deemed to be residents in China. Domicile refers to habitual residence in China on account of domiciliary registration, family ties or economic interests. The days on a temporary trip away from China, including a single trip not exceeding 30 days or combined trips not exceeding 90 days, shall not be deducted. Habitual residence is a legal criterion whereby a taxpayer is defined and it does not refer to actual residence or residence of an individual for a particular period of time. For example, China is the habitual residence of an individual who should come back to reside in China after staying, working, visiting families and touring in a place other than China (OECD, 2018).

This was further summarized by KPMG as follows:

An individual is domiciled in China if that person habitually resides in China. This means the individual's permanent registered address, family ties and economic interests would be in China. An individual with a Chinese passport or a "hukou" (household registration) is generally regarded as being domiciled in China. Generally, a foreign national is treated as a non-domicile in China. A non-domicile is treated as being a resident for any year that the individual lives in China for 365 days, without a single period of absence of more than 30 days consecutively or cumulative periods of absence of more than 90 days within the same calendar year. Individuals of China, domiciles and non-domiciles,

who are long-term residents, are liable for tax on worldwide income. Non-domiciles who are residents for less than five years are generally liable for tax on China-sourced employment income only (KPMG, 2018).

This was also summarized by PWC:

Individuals who have “domicile or place of abode” in China are those who maintain residence in China due to their legal residency status, family, or economic ties and who habitually reside in China. Foreign individuals are taxed according to their physical presence in China as follows: Foreign individuals who reside in China for less than one year will be taxed on their China-sourced income and not worldwide income. Foreign individuals who reside in China for more than one year but not more than five consecutive “full” years, will be subject to tax on China- and foreign-sourced income. However, as a concession, foreign-sourced income is taxed only if the income was paid or borne by a China entity.

Foreign individuals who reside in China for more than five consecutive full years will be subject to tax on their worldwide income from the sixth consecutive full year onward. Foreign individuals who travel in China and derive income from an overseas employer with no permanent establishment in China will be tax exempt if they do not physically stay in China cumulatively for more than 90 days in a calendar year. If the individual is a tax resident of a country/region that has concluded a tax treaty/arrangement with China, the 90-day threshold is extended to 183 days during a calendar year or any 12 consecutive months, depending on the applicable tax treaty/arrangement (PWC, 2018).

LehmanBrown International Accountants is a China-focused accounting, taxation, audit and business advisory firm who clarified the five-year rule as follows:

“For an expatriate, he or she will qualify as a Chinese resident if he or she is a foreign national living and working in China for more than 5 years. This means that the expatriate does not leave China for a consecutive period of 30 full days or a total of 90 full days throughout the calendar year “(LehmanBrown, not dated).

4.2.2 Double Taxation Agreement

In terms of Section 4 of the double taxation agreement, “Resident” means:

“1. For the purposes of this Agreement, the term ‘resident of a Contracting State’ means:

- a) in China, any person who, under the laws of China, is liable to tax therein by reason of his domicile, residence, place of head office or any other criterion of a similar nature;
- b) in South Africa, any individual who is ordinarily resident in South Africa and any other person who has his place of effective management in South Africa;
- c) that State and any political subdivision or local authority thereof.

2. Where, by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

- a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
- b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
- c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
- d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement” (SARS, 2001).

4.2.3 Key differences between South Africa and China's residency definition for consideration

The Chinese “domicile/place of abode” principle is basically the same as the South African “ordinarily resident” principle. What is interesting to note is that, like South Africa, China also does not have a time-based rule with regards to determining the place of domicile or abode.

China’s physical presence test looks very similar to South Africa’s physical presence test in the fact that it also expands over 5 years. The days, however, differ since China

has a 30-day versus a 90-day requirement depending on whether the days are consecutive or not. South Africa does not have this, which is something to consider. They also do not have a total number of days over 5 years that the individual needs to be present in China in order to be considered a resident like South Africa does (915 days in total).

It is also interesting to note that China differentiates between foreign individuals who are physically present for one year and foreign individuals who are present for five years. The tax treatment for an individual staying in China for one year is different in the sense that they will only be taxed on foreign-sourced income if that income was paid/borne by a Chinese entity. South Africa makes no such differentiation and this could be something to consider.

4.3 India

A comparative discussion between South Africa and India's residency definition is discussed below.

4.3.1 Residency definition of India as per the Income Tax Act of India of 1961 section 6

“Residence” in India.

6. For the purposes of this Act,—

(1) An individual is said to be resident in India in any previous year, if he—

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or

(b) [***]

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

Explanation. 1—In the case of an individual,—

(a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958), or for the purposes of employment outside India, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted ;

(b) being a citizen of India, or a person of Indian origin within the meaning of *Explanation* to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted.

Explanation 2.—For the purposes of this clause, in the case of an individual, being a citizen of India and a member of the crew of a foreign bound ship leaving India, the period or periods of stay in India shall, in respect of such voyage, be determined in the manner and subject to such conditions as may be prescribed.

- (2) A Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year in every case except where during that year, the control and management of its affairs is situated wholly outside India.
- (4) Every other person is said to be resident in India in any previous year in every case, except where during that year, the control and management of his affairs is situated wholly outside India.
- (5) If a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other sources of income.
- (6) A person is said to be "not ordinarily resident" in India in any previous year if such person is—
- (a) an individual who has been a non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less; or
- (b) a Hindu undivided family whose manager has been a non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less."

This is also summarised as follows by the OECD:

For an individual, tax residency is decided on the basis of number of days stayed in India. Generally, an individual is said to be a resident in India in a fiscal year if he is in India for more than 182 days (OECD, 2018).

This is further clarified on the Ernst and Young (EY) (Not dated) website as follows:

As per the tax law, an individual is considered to be a tax resident if he or she is present in India for:

- 182 days or more in a fiscal year, or
- 60 days or more in a fiscal year and 365 days or more during the preceding 4 fiscal years; the 60 days may be extended to 182 days in certain cases.

It is important to take into account that in India there are two types of tax residents:

- Resident and not ordinarily resident (RNOR) and

- Resident and ordinarily resident (ROR)

A resident individual who satisfies either of the following additional conditions will be classified as a resident and not ordinarily resident if:

- The individual has been a non-resident in India for at least 9 out of the preceding 10 fiscal years.
- The individual has been in India for 729 days or less during the preceding 7 fiscal years.

If an individual does not satisfy both of these additional conditions, he/she is classified as a resident and ordinary resident. Ordinary residents will be taxed on their worldwide income and non-resident, and individuals, who qualify as residents but not ordinarily residents will be taxed on income received and deemed to be received in India, as well as income accruing/arising in India, or deemed to accrue or arise in India (EY, 2018).

It is important to note that it is not necessary for the stay to be for a continuous period or be at one place in India. A person may be resident of more than one country for any previous year.

A person coming to India for the first time would be treated as a “not ordinarily resident” for the first two years of his stay. If this person is treated as a Non Resident in the year of arrival, then he would be treated as a “not ordinarily resident” for the second and third year of his stay in India. An individual who has left India and remains non-resident for at least nine years preceding his return to India, or whose stay in the seven years preceding the year of return has not exceeded 729 days would, upon his return, be treated as a “non-resident” or a “not ordinarily resident” depending upon the number of days stay in India in the year of return. The status of a “not ordinarily resident” will remain effective for two years including or following the year of return (Gupta, 2014).

4.3.2 Double Taxation Agreement with South Africa

In terms of Section 4 of the double taxation agreement, “Resident” means:

“1. For the purposes of this Agreement, the term "resident of a Contracting State" means:

(a) in India, any person who, under the laws of India, is liable to tax therein by reason

of his domicile, residence, place of management or any other criterion of a similar nature, but this term does not include any person who is liable to tax in India in respect only of income from sources in India;

(b) in South Africa, any individual who is ordinarily resident in South Africa and any other person which has its place of effective management in South Africa.

2. Where, by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);

(b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

(c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

(d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement” (SARS, 1997).

Paragraph 1(a) of section 4 refers to the words “domicile” which is not really applicable according to the residency definition of India since their definition focuses on physical presence and not domicile.

4.3.3 Key differences between South Africa and India’s residency definition for consideration

As previously noted in chapter 3, one of the potential inefficiencies of the South African resident definition is the fact that there is no time-based rule involved when it comes to the definition of “ordinarily resident”. Here it is clear that the Indian residency definition is founded purely on a time-based rule, namely a physical presence type of approach. India’s definition does not take into account a natural person’s domicile or place of habitual abode.

This is definitely a more objective approach in determining a person's residency status. Since India is one of the BRICS countries and also has a lot of nationals working abroad, their objective residency definition would be more practical than South Africa's "ordinarily resident" definition which does not specify any time period. It is more practical in the sense that it is easier to determine when a person would be a resident of a particular country when purely considering where the person physically was. It is also easier to determine a natural person's physical presence in a country than to determine a person's true intention.

In addition, if one compares the number of days of India's physical presence requirement, to South Africa's physical presence requirement, there is a significant difference. With South Africa's physical presence test, one would only be considered to be a resident after six years of proven presence in South Africa. In India, one would be a resident after either one year or four years, depending on the type of residency. Therefore, India's physical presence period that is considered, is quite a bit shorter.

The fact that India differentiates between ordinarily resident and not ordinarily resident but still resident, is also something South Africa could consider. This would possibly enable expats working in other countries to still qualify as residents, even if they are not ordinarily resident, and be taxed on South African source income only. This could potentially lead to a lesser degree of non-compliance to the residency definition.

4.4 Switzerland

A comparative discussion between South Africa and Switzerland's residency definition is discussed below.

Since the Swiss Income tax Act (Bundesgesetz über die direkte Bundessteuer, 1990) is only written in German, the OECD model's definition (OECD, 2018) is used as the primary source and in addition, there will be reference to other summaries from reliable sources.

South Africa is one of the many non-member economies with which the OECD has a working relationship. South Africa, being Africa's largest economy, is the prime mover

for OECD activities on taxation, investment, competition policy and governance. South Africa then gains access to OECD expertise and good policy practices (OECD, 2018).

The Organization for Economic Cooperation and Development (OECD) is an accord reached between member states and serves as a guideline for establishing tax agreements. Its primary application is to guide the negotiation of bilateral treaties between two or more countries. This convention consists of articles, commentaries, position statements and special reports on evolving tax issues (Business dictionary, 2018). Therefore, this is a good source to use since these are the generally accepted international guidelines for tax agreements between countries.

4.4.1 Residency definition as per the OECD

For a natural person to qualify as a resident for tax purposes, he or she needs to maintain a tax domicile or a tax residence (place of abode) in Switzerland. An individual living in Switzerland with the intention to stay there permanently, establishes a tax domicile. The definition of “domicile” is the place where a person lives with the intention of staying there permanently. This too, is where a person’s personal relationships are focused and where they regularly spend their non-working hours; where they foster friendships and family ties and where they take part in the social life of the community. This is where the centre of vital interests are. A place of work does not qualify as a tax domicile.

An individual establishes a tax residence (place of abode) irrespective of short interruptions, if a stay of a minimum of 30 days is combined with a gainful activity. If there is no gainful activity, the stay needs to last a minimum of 90 days. An individual who is domiciled abroad, but stays in Switzerland solely for educational or health reasons, is not deemed to be a resident in Switzerland for tax purposes.

Government officials or individuals working for a public law corporation or institution who live outside the territory of Switzerland, and are in this jurisdiction subject to a partial or total income tax deduction, remain liable to taxation in Switzerland. The provisions of applicable conventions for the avoidance of double taxation are reserved (OECD, 2018).

This was further explained by Dr R Bloch-Riemer in 2017:

Tax residency in Switzerland can be achieved by two categories, namely Domicile, which comprises of Domicile elect and Domicile by operation of law; and qualifying residency, which defines the permanent abode concept. These types of Swiss tax residency lead to the same result from a Swiss domestic tax perspective, and that is an unlimited tax liability.

As per Article 3 par 2 of the Direct Federal Tax Act, for tax purposes, a person has his/her domicile in Switzerland if he/she resides within the territory, with the intent of permanently staying in the country, or if the federal laws assign a special legal domicile.

Establishing the elected Domicile: In order to determine an individual's intention to stay permanently, only objective external facts would be considered. The declaration of intent is neither necessary nor sufficient to establish domicile. Temporary interruption of the stay is not harmful if it is less than two years and the stay should not merely be of a temporary nature. However, temporary stays can fulfill the requirement of permanence if it is of a minimum duration of one year.

The centre of vital interests will be determined by considering personal and family relations, age, marital status, permanent home and duration and purpose of stay etc.

As per Article 3 par 3 of the Direct Federal Tax Act, habitual residence can be determined as follows: A person has a place of residence in Switzerland if he/she, irrespective of temporary interruptions, a) resides within the territory for at least 30 days and exercises an employment or b) resides within the territory for at least 90 days and does not exercise an employment. In this case, only physical presence is decisive (Bloch-Riemer, 2017).

This was also explained by PWC as follows:

An individual will qualify as a tax resident under Swiss domestic tax law if that person has the intention to permanently establish his/her usual abode in Switzerland, which is usually where his/her centre of vital interests are, and is registered with the municipal authorities. Or, if the individual stays in Switzerland with the intention to exercise gainful

activities for a consecutive period of at least 30 days, or if there is no intention to exercise gainful activities, the period needs to be at least 90 days (PWC, 2018).

4.4.2 Double Taxation Agreement with South Africa

In terms of Section 4 of the double taxation agreement, "Resident" means:

“1. For the purposes of this Convention, the term *resident of a Contracting State* means any person who, under the laws of that State, is liable to tax therein by reason of that person's domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources therein.

2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then that individual's status shall be determined as follows:

a) the individual shall be deemed to be a resident solely of the State in which a permanent home is available to the individual; if a permanent home is available to the individual in both States, the individual shall be deemed to be a resident solely of the State with which the individual's personal and economic relations are closer (centre of vital interests);

b) if sole residence cannot be determined under the provisions of subparagraph (a), or if the individual has not a permanent home available in either State, the individual shall be deemed to be a resident solely of the State in which the individual has a habitual abode;

c) if the individual has a habitual abode in both States or in neither of them, the individual shall be deemed to be a resident solely of the State of which the individual is a national;

d) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement” (SARS, 2009).

4.4.3 Key differences between South Africa and Switzerland's residency definition for consideration

The concept of having a “tax domicile” and place of habitual abode is basically similar to South Africa’s “ordinarily resident” definition. The important fact to note here is that Switzerland specifies that your place of work does not qualify as a tax domicile. The fact that where you work has no influence on your ordinary residence is something that South Africa could emphasize with regards to the “ordinarily resident” definition. It is also interesting to see that Switzerland has a physical presence requirement attached to their tax domicile definition, this requirement differs depending on whether a person is involved in gainful activity or not. As previously mentioned, South Africa lacks a time-based rule in their “ordinarily resident” definition, which Switzerland brings in with their 30 and 90 days’ rule. This is also a much more objective way of determining residency for tax purposes.

Although one could argue that its 30 and 90 days’ tests are similar to our physical presence test, it is still very different in the sense that the days that you need to be present in Switzerland is significantly less than in South Africa’s physical presence test; in addition, the number of days are dependent on whether a person is involved in gainful activity or not. South Africa’s physical presence test does not take into account whether a person is involved in gainful activity or not. The reason for a person’s physical presence in South Africa is not taken into account at all when exercising the physical presence test. This is another potential change that South Africa could consider, to establish different rules for physical presence based on gainful activity.

As noted by Dr Bloch-Riemer, in order to determine an individual’s intention to stay permanently, only objective external facts would be considered. The declaration of intent is neither necessary nor sufficient to establish domicile. To only focus on objective external factors and not a person’s declaration of intent, is certainly something South Africa can take into account when determining a person’s intention for “ordinarily resident” purposes.

4.5 United Kingdom

A comparative discussion between South Africa and the UK's residency definition is discussed below.

4.5.1 Change in the UK residency definition

The UK decided to change their residency definition in 2013 and aimed to remove any grey areas when determining an individual's residence status for tax purposes in the UK. The previous definition worked on the basis that if a person was in the UK for 183 days or more in a single tax year, or more than 90 days on average in a single tax year over the previous four tax years, that individual qualified as a UK resident. The new test includes tests to determine whether an individual is automatically non-resident or automatically resident; these tests also analyse an individual's connections with and ties to the UK. These include family, property, work and social connections (Feathersby, 2013:8).

South African courts relied on the judgements of the English courts for guidance regarding our "residence" and "ordinary residence" definition (Arendse, Renaud & Stark, 2016).

It is, therefore, a very good reason to regard the evolution of the UK residency definition as an important measure for South Africa's residency definition.

In aiming to bring more certainty to the UK residency definition, the UK introduced the Statutory Residence Test in 2013. Until 2013, the UK had no definition for "resident" and relied on case law. They then abandoned the concept of "ordinary residence" and introduced the statutory residence test. This statutory residence test was intended to eliminate the concept of ordinary residence as far as possible (Her Majesty Revenue & Customs, 2013).

The Statutory Residence Test provides a practical approach in determining residency and this recognizes the migration pattern of many taxpayers (Arendse, Renaud & Stark, 2016).

4.5.2 Residency definition

UK tax residency is determined by the Statutory Residence Test. This test determines who is a resident and who is not a resident in the UK for tax purposes. This is basically achieved by applying fact-based tests that take into account the time spent in the UK, whether an individual's only home is in the UK, whether they work in the UK on a full-time basis and their connections to the UK. In general, individuals who spend more than half of the year in the UK are likely to qualify as residents for tax purposes (OECD, 2018).

The Statutory Residence Test is detailed in the Finance Act of 2013 as seen below:

In terms of Schedule 45 to the Finance Act 2013 Part 1:

The basic rule

3 An individual ("P") is resident in the UK for a tax year ("year X") if—

- (a) the automatic residence test is met for that year, or
- (b) the sufficient ties test is met for that year.

4 If neither of those tests is met for that year, P is not resident in the UK for that year.

The automatic residence test

5 The automatic residence test is met for year X if P meets—

- (a) at least one of the automatic UK tests, and
- (b) none of the automatic overseas tests.

The automatic UK tests

6 There are 4 automatic UK tests.

7 The first automatic UK test is that P spends at least 183 days in the UK in year X.

8 (1) The second automatic UK test is that—

- (a) P has a home in the UK during all or part of year X,
- (b) that home is one where P spends a sufficient amount of time in year X, and
- (c) there is at least one period of 91 (consecutive) days in respect of which the following conditions are met—

- (i) the 91-day period in question occurs while P has that home,
- (ii) at least 30 days of that 91-day period fall within year X, and
- (iii) throughout that 91-day period, condition A or condition B is met or a combination of those conditions is met.

(2) Condition A is that P has no home overseas.

(3) Condition B is that—

(a) P has one or more homes overseas, but

(b) each of those homes is a home where P spends no more than a permitted amount of time in year X.

(4) In relation to a home of P's in the UK, P "spends a sufficient amount of time" there in year X if there are at least 30 days in year X when P is present there on that day for at least some of the time (no matter how short a time).

(5) In relation to a home of P's overseas, P "spends no more than a permitted amount of time" there in year X if there are fewer than 30 days in year X when P is present there on that day for at least some of the time (no matter how short a time).

(6) In sub-paragraphs (4) and (5)—

(a) a reference to 30 days is to 30 days in aggregate, whether the days are consecutive or intermittent, and

(b) a reference to P being present at the home is to P being present there at a time when it is a home of P's (so presence there on any other occasion, for example to look round the property with a view to buying it, is to be disregarded).

(7) Sub-paragraph (1)(c) is satisfied so long as there is a period of 91 days in respect of which the conditions described there are met, even if those conditions are in fact met for longer than that.

(8) If P has more than one home in the UK—

(a) each of those homes must be looked at separately to see if the second automatic UK test is met, and

(b) the second automatic UK test is then met so long as it is met in relation to at least one of those homes.

9 (1) The third automatic UK test is that—

(a) P works sufficient hours in the UK, as assessed over a period of 365 days,

(b) during that period, there are no significant breaks from UK work,

(c) all or part of that period falls within year X,

(d) more than 75% of the total number of days in the 365-day period on which P does more than 3 hours' work are days on which P does more than 3 hours' work in the UK, and

(e) at least one day, which falls in both that period and year X, is a day on which P does more than 3 hours' work in the UK.

(2) Take the following steps to work out, for any given period of 365 days, whether P works "sufficient hours in the UK", as assessed over that period—

- *Step 1*

Identify any days in the period on which P does more than 3 hours' work overseas, including ones on which P also does work in the UK on the same day.

The days so identified, are referred to as "disregarded days".

- *Step 2*

Add up (for all employments held and trades carried on by P) the total number of hours that P works in the UK during the period, but ignoring any hours that P works in the UK on disregarded days.

The result is referred to as P's "net UK hours".

- *Step 3*

Subtract from 365—

(a) the total number of disregarded days, and

(b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.

The result is referred to as the "reference period".

- *Step 4*

Divide the reference period by 7. If the answer is more than 1, and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.

- *Step 5*

Divide P's net UK hours by the number resulting from step 4. If the answer is 35 or more, P is considered to work "sufficient hours in the UK" as assessed over the 365-day period in question.

(3) This paragraph does not apply to P if—

- (a) P has a relevant job on board a vehicle, aircraft or ship at any time in year X, and
- (b) at least 6 of the trips that P makes in year X as part of that job are cross-border trips that either begin in the UK, end in the UK or begin and end in the UK.

10 (1) The fourth automatic UK test is that—

- (a) P dies in year X,
- (b) for each of the previous 3 tax years, P was resident in the UK by virtue of meeting the automatic residence test,
- (c) even assuming P were not resident in the UK for year X, the tax year preceding year X would not be a split year as respects P (see Part 3 of this Schedule),
- (d) when P died, either—
 - (i) P's home was in the UK, or
 - (ii) P had more than one home and at least one of them was in the UK,and
- (e) if P had a home overseas during all or part of year X, P did not spend a sufficient amount of time there in year X.

(2) In relation to a home of P's overseas, P "spent a sufficient amount of time" there in year X if—

- (a) there were at least 30 days in year X when P was present there on that day for at least some of the time (no matter how short a time), or
- (b) P was present there for at least some of the time (no matter how short a time) on each day of year X up to and including the day on which P died.

(3) In sub-paragraph (2)—

- (a) the reference to 30 days is to 30 days in aggregate, whether the days were consecutive or intermittent, and
- (b) the reference to P being present at the home is to P being present there at a time when it was a home of P's.

(4) If P had more than one home overseas—

- (a) each of those homes must be looked at separately to see if the requirement of sub-paragraph (1)(e) is met, and
- (b) that requirement is then met so long as it is met in relation to each of them.

The automatic overseas tests

11 There are 5 automatic overseas tests.

12 The first automatic overseas test is that—

- (a) P was resident in the UK for one or more of the 3 tax years preceding year X,
- (b) the number of days in year X that P spends in the UK is less than 16, and
- (c) P does not die in year X.

13 The second automatic overseas test is that—

- (a) P was resident in the UK for none of the 3 tax years preceding year X, and
- (b) the number of days that P spends in the UK in year X is less than 46.

14(1) The third automatic overseas test is that—

- (a) P works sufficient hours overseas, as assessed over year X,
- (b) during year X, there are no significant breaks from overseas work,
- (c) the number of days in year X on which P does more than 3 hours' work in the UK is less than 31, and
- (d) the number of days in year X falling within sub-paragraph (2) is less than 91.

(2) A day falls within this sub-paragraph if—

- (a) it is a day spent by P in the UK, but
- (b) it is not a day that is treated under paragraph 23(4) as a day spent by P in the UK.

(3) Take the following steps to work out whether P works “sufficient hours overseas” as assessed over year X—

- *Step 1*

Identify any days in year X on which P does more than 3 hours' work in the UK, including ones on which P also does work overseas on the same day.

The days so identified are referred to as “disregarded days”.

- *Step 2*

Add up (for all employments held and trades carried on by P) the total number of hours that P works overseas in year X, but ignoring any hours that P works overseas on disregarded days.

The result is referred to as P's “net overseas hours”.

- *Step 3*

Subtract from 365 (or 366 if year X includes 29 February)—

- (a) the total number of disregarded days, and
- (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.

The result is referred to as the “reference period”.

- *Step 4*
Divide the reference period by 7. If the answer is more than 1, and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.
- *Step 5*
Divide P’s net overseas hours by the number resulting from step 4.
If the answer is 35 or more, P is considered to work “sufficient hours overseas” as assessed over year X.

(4) This paragraph does not apply to P if—

- (a) P has a relevant job on board a vehicle, aircraft or ship at any time in year X, and
- (b) at least 6 of the trips that P makes in year X as part of that job are cross-border trips that either begin in the UK, end in the UK or begin and end in the UK.

15 (1) The fourth automatic overseas test is that—

- (a) P dies in year X,
- (b) P was resident in the UK for neither of the 2 tax years preceding year X or, alternatively, P’s case falls within sub-paragraph (2), and
- (c) the number of days that P spends in the UK in year X is less than 46.

(2) P’s case falls within this sub-paragraph if—

- (a) P was not resident in the UK for the tax year preceding year X, and
- (b) the tax year before that was a split year as respects P because the circumstances of the case fell within Case 1, Case 2 or Case 3 (see Part 3 of this Schedule).

16 (1) The fifth automatic overseas test is that—

- (a) P dies in year X,

(b) P was resident in the UK for neither of the 2 tax years preceding year X because P met the third automatic overseas test for each of those years or alternatively, P's case falls within sub-paragraph (2), and

(c) P would meet the third automatic overseas test for year X if paragraph 14 were read with the relevant modifications.

(2) P's case falls within this sub-paragraph if—

(a) P was not resident in the UK for the tax year preceding year X because P met the third automatic overseas test for that year, and

(b) the tax year before that was a split year as respects P because the circumstances of the case fell within Case 1 (see Part 3 of this Schedule).

(3) The relevant modifications of paragraph 14 are—

(a) in sub-paragraph (1)(a) and (b) and sub-paragraph (3), for "year X" read "the period from the start of year X up to and including the day before the day of P's death", and

(b) in step 3 of sub-paragraph (3), for "365 (or 366 if year X includes 29 February)" read "the number of days in the period from the start of year X up to and including the day before the day of P's death".

The sufficient ties test

17 (1) The sufficient ties test is met for year X if—

(a) P meets none of the automatic UK tests and none of the automatic overseas tests, but

(b) P has sufficient UK ties for that year.

(2) "UK ties" is defined in Part 2 of this Schedule.

(3) Whether P has "sufficient" UK ties for year X will depend on—

(a) whether P was resident in the UK for any of the previous 3 tax years, and

(b) the number of days that P spends in the UK in year X.

(4) The Tables in paragraphs 18 and 19 show how many ties are sufficient in each case.

Sufficient UK ties

18 The Table below shows how many UK ties are sufficient in a case where P was resident in the UK for one or more of the 3 tax years preceding year X—

<i>Days spent by P in the UK in year X</i>	<i>Number of ties that are sufficient</i>
More than 15 but not more than 45	At least 4
More than 45 but not more than 90	At least 3
More than 90 but not more than 120	At least 2
More than 120	At least 1

19 The Table below shows how many UK ties are sufficient in a case where P was resident in the UK for none of the 3 tax years preceding year X—

<i>Days spent by P in the UK in year X</i>	<i>Number of ties that are sufficient</i>
More than 45 but not more than 90	All 4
More than 90 but not more than 120	At least 3
More than 120	At least 2

20 (1) If P dies in year X, paragraph 18 has effect as if the words “More than 15 but” were omitted from the first column of the Table.

(2) In addition to that modification, if the death occurs before 1 March in year X, paragraphs 18 and 19 have effect as if each number of days mentioned in the first column of the Table were reduced by the appropriate number.

(3) The appropriate number is found by multiplying the number of days, in each case, by—

$$A/12$$

where “A” is the number of whole months in year X after the month in which P dies.

(4) If, for any number of days, the appropriate number is not a whole number, the appropriate number is to be rounded up or down as follows—

- (a) if the first figure after the decimal point is 5 or more, round the appropriate number up to the nearest whole number,
- (b) otherwise, round it down to the nearest whole number.

This test was clearly explained in an article by Jonathan Colclough in 2014.

The Statutory Residence Test makes provision for the following circumstances:

- The automatic overseas tests determine when an individual is definitely not a resident in the UK;
- The automatic residence tests determine when an individual is definitely a resident in the UK;
- The sufficient ties test determines other circumstances where there is a middle ground.

These tests are applied in the above order of priority.

The automatic overseas test:

If you have not been a resident in the UK for the last three tax years and you have been physically present in the UK for a maximum of 45 days in the current tax year, you will not qualify as a resident of the UK for tax purposes. If, however, you have been a resident in the UK for any of the last three tax years and you have been in the country for a maximum of 15 days in the current tax year, you will still not qualify as a resident. If an individual leaves the UK to work full-time abroad and satisfy the specific conditions of that test, that individual would also not qualify as a resident of the UK.

The automatic residence test:

If an individual spends 183 days or more in the UK in a tax year, then that individual qualifies as a resident in the UK for tax purposes. You will also qualify as a resident if you have a home in the UK and are present in that home for 30 or more separate days in the current tax year, and you have no home overseas or if you have one or more homes overseas and you are present for shorter than 30 days in each of those homes. If you work full time (at least 35 hours per week) over a 365-day period without a significant break and you are in the UK for more than 75% of those days, you will also qualify as a resident for tax purposes.

Sufficient ties test:

This test works on a sliding scale, which is based on the number of days that you spend in the UK and the number of ties that you have to the UK. The scale differentiates between whether you are an arriver or a leaver. An arriver is an individual who was not a resident in the UK in the last three years. A leaver is an individual who was a resident in the UK in the last three years. The ties that are taken into account for the number of ties in the UK are as follows:

- Your spouse/civil partner/common law equivalent or minor children are resident in the UK.
- Accommodation available in the UK.
- You have substantive employment in the UK (40 working days or more, where 1 working day equals 3 or more hours of work)
- You spend 90 days or more in the UK in either of the previous two tax years.
- You spend more time in the UK than in other countries, however, this would only be relevant for leavers (Colclough, 2014).

As explained by Binder Dijker Otte (BDO), there are a few key points that need to be considered when doing the Statutory Residence Test. In a few exceptional circumstances, some of the physical presence days may be disregarded. A tax year may be split into two, with a period of residence and a period of non-residence in certain situations. There are also detailed anti-avoidance rules in place for individuals leaving the UK for short periods (BDO, 2015).

4.5.3 Double taxation agreement

In terms of Section 4 of the double taxation agreement “Resident” means:

1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of that person’s domicile, residence, place of management, place of incorporation or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.
2. Where, by reason of the provisions of paragraph 1 of this Article, an individual is a resident of both Contracting States, then that individual’s status shall be determined in accordance with the following rules:

- (a) the individual shall be deemed to be a resident solely of the Contracting State in which a permanent home is available to the individual; if a permanent home is available to the individual in both States, the individual shall be deemed to be a resident solely of the State with which the individual's personal and economic relations are closer (centre of vital interests);
- (b) if sole residence cannot be determined under the provisions of sub-paragraph the individual shall be deemed to be a resident solely of the State in which the individual has an habitual abode;
- (c) if the individual has an habitual abode in both Contracting States or in neither of them, the individual shall be deemed to be a resident solely of the State of which the individual is a national;
- (d) if the individual is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement (SARS, 2003).

4.5.4 Key differences between South Africa and the UK's residency definition for consideration

The UK specifically changed its definition to move away from the "ordinary residence" definition. This caused the new Statutory Residence Test to be a clearer and more practical way of determining an individual's residence. In other words, they acknowledged the shortcomings of and difficulty in applying the "ordinary residence" definition. This is definitely something South Africa could consider. When looking at the UK's Statutory Residence Test, there are definite time-based rules in determining residency, something that South Africa's "ordinary residence" definition lacks. South Africa could certainly benefit in expanding its ordinary residency definition and adding more time-based clear rules.

The UK's test also provides for a wide range of possibilities for migrating individuals, making their test clearer and easy to apply. South Africa can definitely benefit from making its physical presence test more detailed to include more than one situation.

The other important thing to note is that one can split a tax year and qualify as a resident for a part of the year and a non-resident for the other part of the year. This would prevent non-compliance and also eliminate uncertainties for individuals who are in transit.

CHAPTER 5 CONCLUSION & RECOMMENDATIONS

5.1 Objective of this chapter

The objective of this chapter is to provide a summary of key findings of the study and how these findings address the research question formulated in Chapter 1.

5.2 Research findings

The research findings and how the research objectives of this study have been met, are discussed in the following section.

5.2.1 Primary objective addressed

The primary objective of this study is to determine whether the South African definition of residency is still relevant in light of changes to the legislation (S10(1)(o) of the Income Tax Act) regarding natural persons working abroad, and in comparison to international legislation or practice. The current definition could potentially lead to non-compliance.

This objective has been addressed in detail under the three secondary objectives. As suggested in the objectives addressed below, the current definition could be amended to prevent non-compliance; specifically regarding the adding of a time-based rule, which would result in a more objective way of determining residency.

5.2.2 Secondary objective 1

The first secondary objective is to consider the historical development of the residency and source taxation bases in order to understand the reasoning behind the development of the South African residency definition.

The historical development was researched and a better understanding of how the South African taxation base evolved, was achieved. The main reasoning for changing to a worldwide basis of taxation was to bring South Africa more in line with international tax principles, to protect the tax base from exploitation and to broaden the tax base. The change from a source-based taxation system to a residency-based system placed additional emphasis on the residency definition, so this definition became very important.

5.2.3 Secondary objective 2

The second secondary objective is to analyse the South African residency definition as it is, and to identify possible areas of non-compliance and uncertainty.

The lack of a specific timeline and time-basis rule in our definition is a potential problem. This is in addition to the fact that “ordinary resident” is not adequately defined and one needs to consider the taxpayer's intention in order to determine residency, which is not an objective test.

One year of non-compliance of the physical presence test requirement would lead to the chain being broken and the six-year cycle would have to start again. This could lead to potential non-compliance. Since South Africa does not have double taxation agreements with all the countries, the lack thereof could lead to potential non-compliance.

5.2.4 Secondary objective 3

The last secondary objective is to do a comparison of the residency definition to other countries, and to consider what the DTA's specify regarding the residency definition.

The international comparison brought about certain main differences, which are summarized in the tables below. The main differences consist of a time-based rule that South Africa lacks, which can be found in the definition of most of the countries reviewed. This would eliminate the subjective factor of considering a taxpayer's intention. The other main difference would be the period that most countries consider for their physical presence tests. These periods mostly differ significantly from South Africa in the sense that they are a lot shorter than the six years considered by South Africa.

Table 1: South African comparison to BRICS countries

	SA	CHINA	INDIA
Time-based element in ordinary resident definition	No	No	Yes
Use of Domicile/ place of abode principle in definition	Yes	Yes	No
Physical presence test and period it considers.	Yes, 6 years	Yes, 5 years	Yes, 1 - 4 years

Table 2: South African comparison to countries with advanced economies

	SA	SWITZERLAND	UNITED KINGDOM
Time-based element in ordinary resident definition	No	Yes	Yes
Use of Domicile/ place of abode principle in definition	Yes	Yes	No
Physical presence test and period it considers.	Yes, 6 years	Yes, 30 - 90 days	Yes, differs depending on circumstances (longest 3 years)

5.3 Overall conclusion and recommendations

The “ordinarily resident” definition needs to be clarified and should contain a time-based rule, which would make this a more objective test. The physical presence test should be more in line with international standards and could possibly be refined, like the UK’s Statutory Residence Test, to take into account a variety of different situations. The period the physical presence test considers should also be reviewed to bring it more in line with the international tendency to consider a shorter period for a physical presence test.

The tables under 5.2.4 clearly summarized the main differences between South Africa and the other countries researched. This could be used as a simplified summary of this study’s findings.

Further research could be done on what the effect of the proposed amendments in this dissertation would have on the South African taxation base.

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