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Sir

DRAFT INTERPRETATION NOTE: EXEMPTION FROM INCOME TAX: FOREIGN EMPLOYMENT INCOME

We refer to the request to comment on the draft interpretation note (issue 2) dealing with exemption from income tax: foreign employment income. In our comments below, when we refer to this draft note, we will use the abbreviation "Draft Note".

The comments are presented under the relevant paragraphs as they are found in the Draft Note.

Paragraph 4.1.1 – Remuneration

Comment - for services rendered

The words, "for services rendered", that follows the word 'allowance' in the first sentence do not appear in the legislation in the context of the "by way of" requirement. The qualification in this regard is that the 'qualifying remuneration must be 'in respect of services rendered outside the Republic' and that issue is dealt with in the next paragraphs.

The purpose of the introduction of the words 'by way of' and the specific identified items was "that the remuneration must be for services rendered while outside the Republic, amounts, for example, referred to in paragraph (d) of the definition of 'gross income' will not fall within the exemption" (as explained in the 2007 Explanatory Memorandum).

Comment – footnotes 2, 3, 4 and 5

The last sentence in the first paragraph (Amounts contemplated in paragraph (i) of the definition of "gross income" in section 1(1) are also included (2), as too are amounts referred to in section 8(3), 8B (4) or 8C(5)) merely duplicates the law. The footnotes then provide the detail.

Suggestion

We suggest that the paragraph would be easier to read if the detail in the footnote are included in this paragraph.

Comment – second and third paragraph

The second and third paragraph of this paragraph reads as follows:

> "The exemption relates to remuneration received or accrued for services that were rendered outside the Republic (see 4.1.4) during the qualifying periods (see 4.1.5). Periods outside the Republic where no remuneration was earned fall outside the ambit of section 10(1)(o)(ii).
>
> Remuneration received by or accrued during a qualifying period for services rendered within South Africa does not qualify for exemption. Remuneration earned during a qualifying period in respect of services that were rendered both inside and outside of South Africa must be apportioned (see 4.2) so that only the income relating to foreign services is exempt."

Suggestion

The interpretation provided here is not relevant to the discussion of remuneration and should be moved to the paragraphs referred to.

Paragraph 4.1.2 - Employment relationship

Comments

The Act uses the words "employee for or on behalf of any employer". We agree that it would require an employment relationship and that may imply that the services are "rendered under an employment contract".

We also agree that the use of the words “any employer” (as used in the Act) doesn’t limit the application of the subsection to an employment relationship where the employer is a resident of the RSA. The wording used in the Draft Note is better that those used in the first issue (“…an employer which could either be an employer operating in South Africa, or a non-resident employer”). The principle is then that the interpretation is that the words “any employer” would include persons (as employers) without reference to whether they are residents (of the RSA).

The Draft Note adds the following (which was not in the original note) sentences:

> “An “employee” under the common law excludes an independent contractor or self-employed person.”
>
> “Directors in their capacity as directors are holders of an office, not employees, and to the extent that they earn directors’ fees, such fees do not qualify for exemption under section 10(1)(o)(ii).”

In the Basic Conditions of Employment Act, 1997, "employee" means-

(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and
(b) any other person who in any manner assists in carrying on or conducting the business of an employer.

Judge Basson (in *Chilliebush v Johnston and Others* (JR1234/08) [2010] ZALCJHB 35 (26 January 2010)) said:

> “At the outset it should be pointed out that there is persuasive authority for the notion that a director may, and will ordinarily also be an employee of a company. A director who is also an employee will effectively therefore hold two positions and will act in two different capacities. Different laws will also govern the two positions held by the same individual: As a director of a company he/she will be governed by the provisions of the Companies Act and as an employee, he/she will be governed by the LRA.” (Note: the LRA is the Labour Relations Act).

The problem is that section 10(1)(o)(ii) refers to a fee or emolument. In other words, a director's fee is also remuneration. It would then not qualify as remuneration envisaged in section 10(1)(o)(ii) if it the individual (the director) renders the service in his or her capacity as a director.

The model OECD treaty refers to "directors' fees … in his capacity as a member of the board of directors". In the commentary it is stated that "a member of the board of directors of a company often also has other functions with the company, e.g. as ordinary employee, adviser, consultant, etc. It is clear that the Article does not apply to remuneration paid to such a person on account of such other functions."

We agree that it is likely that a "self-employed person" is not an employee.

Suggestion

The interpretation given in the Draft Note of the word 'employee', particularly in the context of directors fees (the "to the extent that they earn directors' fees" statement), should be reconsidered.

Paragraph 4.1.5 - Days test

Periods outside the RSA (183 or 60 days)

We welcome the interpretation, that:

- "any amount of time in excess of 183 full days … will be sufficient". (We agree that all that is required is that the number must be exceeded, by "a few minutes" as is stated in the 60-days part.)
- "calendar days must be looked at, not only work days"; and that
- "weekends, public holidays, annual leave days, sick leave days and rest periods (as required under the specific terms of a contract of employment) that are spent outside South Africa are taken into account for purposes of calculating the period or periods outside South Africa."

The Draft Note states that "days spent outside of South Africa when a person is not in employment do not qualify as days outside of South Africa under section 10(1)(o)(ii), and are thus not taken into account in the determination of the 183 days for purposes of the exemption."

At issue is not whether these days are 'outside' the RSA, but rather whether they can be added in arriving at the 183 days (or 60 days) total. The legislation uses the words "and those services were rendered during that period or periods". The SARS interpretation is that the services must be rendered during the days of absence (i.e. the 183 or 60 days), but that "calendar days … not only work days" are counted and that "weekends, public holidays, annual leave days, sick leave days and rest periods" in the relevant periods are in effect considered to be workdays. That accords with the legislation, that the "services were rendered during that period or periods".

The legislation deems a "person who is in transit through the Republic between two places outside the Republic and who does not formally enter the Republic" as being outside the RSA.

It is common for the RSA to give to the other treaty partner a right to tax the remuneration if the "the recipient is present" in the other country. In other words, it doesn't require the person to have been rendering services for the period, merely to have been present in the country for the required period (in this instance the 183-days period). In the commentary it is stated that

> "although various formulas have been used by member countries to calculate the 183 day period, there is only one way which is consistent with the wording of this paragraph: the "days of physical presence" method."
>
> "Under this method the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family."

The legislation doesn't require "continuous employment" during the periods outside the RSA.
See our further discussion below (under apportionment) and the related suggestions.

The period of 12 months

It is welcomed that the more extended meaning given to the 'period of 12 months' is accepted over the previous interpretation that the "period must … commence on the first day of a particular month, and end on the last day of the twelfth calendar month thereafter".

Documentation

In terms of the Draft Note the to substantiate absences from South Africa and that the absences were under an employment contract and to render services include "… letters of secondment …" We accept that SARS may request these, but query the reason therefore. A letter of secondment will not in all instances be necessary or available. We also fail to see how it can be relevant to prove employment or days of absence. Surely the employment contract and the passport would be the only documentation required to prove this.

In Example 1, in the Draft Note, it is irrelevant that in terms of contract the person could not "return to South Africa during the period of the secondment". If this individual contravenes the agreement and comes back to the RSA because of death in the family, all that would be relevant (from a section 10(1)(o)(ii) point of view) is whether the number of days outside the RSA is influenced. This is because the 183-day requirement doesn't require a continuous absence.

Paragraph 4.2 - Apportionment of remuneration

As was indicated above, the comments made regarding the days outside the RSA is relevant to this part.

Our concern is with the method, provided in the Draft Note, to determine the exempt portion. The purpose of the method accepted by SARS (referred to as apportionment) is to spread the remuneration evenly over the period outside the RSA (, but only where the period spans more than one year of assessment).

Proviso (C) only applies "in respect of services rendered by that employee in more than one year of assessment" and it is then that "the remuneration is deemed to have accrued evenly over the period that those services were rendered". The period then refers to a period that spans over a year of assessment.

In the 2007 Explanatory Memorandum it was explained that the "amendments make it clear that, to the extent that the conditions of section 10(1)(o)(ii) were met, namely, the 183 day and 60 day tests are met in any twelve month period ending or commencing during any year of assessment during which those services were rendered, during the current year of assessment of previous years, the income earned outside the Republic will be exempt." It continued by saying that the "amendments also make it clear that if remuneration is paid in one year for services rendered in respect of more than one year, such remuneration will be deemed to have accrued evenly over the period that the services were rendered."

The first issue of concern, based on example 2, is that the formula is applied where the services are rendered in one year of assessment. The Draft Note acknowledges that "a bonus that accrues in one year but in relation to services rendered in both the current and the previous year" would have to be split evenly over the years. If the individual (employee) did not render the services "in more than one year of assessment", a bonus that accrues in a period that the individual was outside the RSA is not be deemed to accrue evenly over the period.

We submit that the Act doesn't require an apportionment to be done where the services were not rendered "in more than one year of assessment".

The next concern relates to the statement, in the method, that "only days of actual service are" to "be taken into account." The proviso requires the apportionment to be done "evenly over the period that those services were rendered".

There is no indication given why, when an apportionment is required, they are not seen as days during which services are rendered.

In the example of an employee working on an oil rig it is stated that "no actual services are rendered during the rest periods, even though the employees remain in continuous employment during these periods." In counting the 60 or 183 day periods leave or rest days are taken into account and it is therefore seen as qualifying days. If the individual, due to the weather can also not work on a particular day (whilst on the oil rig) it can't be said that he or she didn't render services. A contract of employment is "a contract of service" (see *Niselow v Liberty Life Association of Africa Ltd*) and it can't be said that the employee is not in service on the rest days. We agree that where the individual is in the RSA during the rest days, they will not qualify for the exemption. In any event, to the extent that the extent that the services are not rendered over more than one year, no apportionment is required. So, if the remuneration for the period on the oil rig is higher than the remuneration whilst the employee is resting, an apportionment would result in some of the remuneration relevant to the period abroad is attributed to the rest period (in the RSA). That is not in terms of the legislation.

We are not sure what the basis was for the interpretation that work days and not calendar days must be used.

In determining the portion of the gain that will be exempt under section 10(1)(o)(ii) during the year in which a section 8A or section 8C event takes place, binding class ruling 25 used calendar days. In example 4 the gain is determined using work days.

Similarly, binding general ruling number 25 (the exemption of foreign pensions under section 10(1)(gC)(ii)) also doesn't refer to working days.

Suggestion

It is suggested that the interpretation that work days must be used when qualifying remuneration that accrued over more than one year of assessment must be reconsidered.

Please feel free to contact us if any clarification is needed with regard to our comments.

Yours sincerely,

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