PRIVATE WEALTH

Making South Africa home?

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Following years of South Africans leaving the country, a noticeable influx of people returning to, or making South Africa their home for the first time, is the latest trend. South Africa is an attractive place to live, retire or spend part of the year. In this article, we consider the fiscal implications of a move to South Africa for individuals with foreign assets and foreign investment structures.

Does a move to South Africa result in a change of tax residence status?

South Africa has a "residence" basis of taxation. South African tax residence is not determined only by citizenship, immigration status or the purchase of immovable property. A natural person becomes tax resident in South Africa under our domestic laws if they are either "ordinarily resident" in South Africa or not "ordinarily resident" but meet the physical presence test, unless they are treaty resident in another jurisdiction which is party to a double tax treaty with South Africa.

In broad terms, a person is ordinarily resident in South Africa if South Africa is their real or settled home, the place to which they would naturally return after temporary periods of absence. The ordinary residence test is a factual enquiry that considers numerous factors to objectively determine whether a person has strong ties to South Africa such that it is regarded as their most settled place of residence.

A person who is not ordinarily resident may still become tax resident under the physical presence test if they spend sufficient time in South Africa over a five-year period. There is a misconception that a person who moves to South Africa can only become tax resident after a five-year period. A person can become "ordinarily resident" in South Africa from their date of arrival if there are sufficient ties indicating they intend to make South Africa their "new home". Only if this is inconclusive (i.e. they retain strong ties in another jurisdiction) will the physical presence test become relevant.

In either case, the provisions of a tax treaty should be considered to determine whether a person is regarded as treaty resident in another country. If so, treaty residence will trump, and they will not become tax resident in South Africa even if they meet one of the local tests. In practice, it is unlikely that a person will meet the ordinary residence test, yet be treaty resident in another jurisdiction.

Impact of becoming or ceasing South African tax residence

Upon becoming tax resident in South Africa, the new resident becomes subject to worldwide tax, but to ensure that worldwide tax is applied only from the date of residence, new residents receive a tax base for their worldwide assets equal to market value on that date. It follows that only the post-residence growth in these assets is exposed to South African tax. For this reason, it is important to have all assets valued on becoming tax resident.

Conversely, when South African residence ceases, the residents are deemed to dispose of their worldwide assets at market value at the time, giving rise to an exit charge on the appreciation of their worldwide assets. Unless the jurisdiction they are moving to allows a similar step-up in base, the same amount may be taxed again by another jurisdiction upon their actual disposal.

Excluded from these rules to step-up base upon becoming tax resident and the exit charge upon cessation of residence are assets such as South African fixed property which remain within the South African tax net irrespective of tax residence.

The tax implications of a move to South Africa can extend to the tax position of any foreign companies, trusts, foundations or other structures in which new residents hold interests. Any involvement in the management of foreign entities from South Africa may draw those foreign entities into the South African tax net.

In addition, South Africa has a variety of tax rules to attribute income or gains arising in foreign structures to South African tax-residents. Amounts arising in a controlled foreign company (essentially a company in which South African residents hold more than 50% of the participation rights) are generally attributed to the South African shareholders in proportion to their shareholding. Where the foreign company is not passive or is subject to tax which is comparable to South African taxes, these rules normally do not apply.

Another set of attribution rules can apply when South African residents enter into transactions which benefit non-residents at the expense of the South African resident, for example a donation or an interest-free loan to a non-resident. In such cases, the South African resident could be subject to South African tax on amounts received by the foreign resident as a result of the donation or the benefit of not paying interest.

Cross-border loans and other transactions with connected non residents need to be reviewed, to determine whether they comply with arm's-length terms to avoid the application of the onerous South African transfer pricing provisions.

All is not bad news, though. Moving to South Africa also holds opportunities to plan foreign asset holding prior to arriving in South Africa. Foreign structures funded with proper planning before South African tax residence commences can be a tax-efficient way of investing.

Income and gains derived by South African tax residents

South African tax residents are, in principle, taxed on worldwide income and capital gains, subject to any relief in terms of applicable tax treaties or rebates for foreign tax paid. This means that the South African tax implications of foreign-source income, pension payouts, trust distributions, and gains on foreign investments should all be considered.

Without attempting to be comprehensive, we discuss a couple of typical foreign investment streams derived by foreigners moving, or ex-South Africans returning, to South Africa.

Foreign pensions

In terms of many of South Africa's tax treaties, South Africa is allocated exclusive taxing rights in relation to pension payments received by South African tax residents. However, South Africa exempts foreign pensions derived as a result of past employment outside South Africa. In these cases, the tax efficiency of retirement in South Africa is obvious.

Foreign dividends

Generally, South Africa will levy tax at a maximum rate of 20% on foreign dividends, subject to credits for foreign taxes on these dividends. Tax treaties may limit the foreign tax which can be levied (and thus credited in South Africa).

Foreign dividends on equity interests of 10% or more are likely to qualify for the participation exemption on foreign dividends.

Foreign interest

South Africa taxes foreign interest of residents at maximum income tax rates, subject to tax credits for foreign taxes levied.

Foreign capital gains

South African tax residents who are natural persons are subject to capital gains tax at a maximum rate of 18% on any capital gains derived from the disposal of their worldwide assets, subject to tax credits for foreign taxes payable. Gains are determined with reference to the stepped-up tax base for assets on becoming tax resident in South Africa, as explained above.

The disposal of substantial foreign equity interests (10% or more) held for 18 months or longer can qualify for the foreign capital gains participation exemption, in which case no South African tax will be payable.

Foreign rental income

Generally, tax treaties allocate primary taxing rights to the country where the rental-earning property is situated. South Africa would, however, also tax and give a credit for the foreign taxes. In countries with generous tax thresholds for rental income, it often is the case that the South African tax exceeds the foreign tax on the rental income.

Foreign funding from discretionary family structures

South Africa has complex rules governing the taxation of awards to South African beneficiaries of foreign family structures. To determine the tax, a South African exercise is required to categorise the retained funds in the structure in accordance with South African tax principles. Awards must be allocated to a specific category of such retained funds. Although the process to categorise the retained funds could be onerous, the result is often that tax efficient funding can be made from foreign structures to South African tax resident beneficiaries. Planning before arrival in South Africa is often critical to achieve the tax efficiency in this regard.

Transfer of wealth during lifetime or at death

Donations tax and estate duty are wealth taxes levied under South African tax legislation. Donations/gift tax is levied at 20% – 25% on donations made by tax residents. Estate duty is raised at similar rates upon the death of a person who is ordinarily resident in South Africa at the date of death.

Assets forming part of investment structures may be included in a resident's estate if the deceased was competent to dispose of them immediately before death. This rule is surprisingly wide and careful consideration should be given to a resident's powers over assets in structures, such as powers typically reserved for settlors or protectors, in order to avoid unexpected onerous estate duty consequences in South Africa.

Donations between spouses are generally exempt. However, following a recent change to South African tax legislation, donations to a non-resident spouse no longer qualify for the exemption. A similar estate duty spousal exemption applies, irrespective of whether the surviving spouse is tax resident in South Africa.

Exemptions from the donations tax and estate duty may also apply to foreign assets acquired before first becoming "ordinarily resident" and those received by inheritance or donation from non-residents, provided they are retained offshore. If an asset is subject to both estate duty and foreign death duty, a local rebate or relief in terms of an estate duty treaty is likely to apply to avoid double taxation.

Exchange control

Tax residence and exchange control residence are distinct, but closely connected and often considered together. If an individual becomes exchange control resident, exchange control rules may affect the movement of funds into and out of South Africa. There will also be disclosure obligations upon becoming exchange control resident, particularly where obtaining residence results in a loop structure. Accordingly, exchange control advice should be sought as part of broader relocation planning.

Plan before you become resident

The tax implications of becoming South African tax resident are manageable and, in certain instances, allow for tax efficiency, but should be considered early. Proactive advice can help to avoid unexpected tax leakage, preserve flexibility, and ensure that offshore wealth structures remain appropriate once South African tax residence becomes relevant.

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