Expat tax is kicking in soon - here's what you should know

If you are a South African working abroad and still a tax resident in South Africa, take note that the so-called "expat tax" will come into effect in South Africa as from 1 March 2020. In effect, the amendments to the Income Tax Act mean that South Africans working overseas will now only be exempt from paying tax on the first R1 million they earn elsewhere.

The rest of their earnings – including all fringe benefits, like housing, education and flight allowances – will now be taxed according to the normal tax tables for the year, which can go up to 45% in some cases.

"The expat tax exemption has always been there; it is now just being capped. This is because the intention was never to have South Africans working abroad not paying any tax at all. Yet this ended up being the case in certain places where no personal taxes are raised, like Dubai," Tim Mertens, chair of Sovereign Trust SA, tells Fin24.

"It is not a sudden change to penalise South Africans working abroad. The SA Revenue Service is merely looking to see where it can find more revenue and the legislation was not intended to give exemption where you end up not paying tax in both your home country and the place where you are working abroad."

He expects the impact will be particularly severe for the thousands of South Africans currently living and working in tax-free geographies, like most countries in the Middle East.

"Don't just keep quiet and do nothing," he advises.

Three options
Richard Neal, managing director of Sovereign Trust (SA), explains that there are basically three options for South Africans earning an income abroad.

1. Moving back to South Africa
Apparently, some South Africans are considering this option, as the new tax law regime will make it difficult to maintain their lifestyles abroad while continuing to honour local commitments, he says.

In Neal's view, however, this is not really an option for many who left for better opportunities and may struggle to find a job in a tough economy in SA.

2. Financial emigration
Financial emigration is the formal process of changing one's tax status with the SA Revenue Service (SARS) and the SA Reserve Bank (SARB) from "resident" to "non-resident".

Neal says one must beware that this is not as simple or cheap.

"If you decide to financially emigrate, you will have to pay capital gains tax on your local assets and impose restrictions on assets remaining and that you might want to acquire in SA. Also, if you come back after five or ten years, your actions will be viewed with some suspicion," he adds.

3. Set up tax-efficient structures
If emigration or financial emigration isn't an option, you could consider setting up a structure to limit your liability and protect your foreign income and assets, he suggests.

For example, this could be setting up an offshore professional services company in a tax-friendly jurisdiction that could then invoice an international employer. However, this would have to take into account the new substance requirements introduced in most of the offshore jurisdictions.

Another option to consider would be an investment portfolio housed within an international retirement plan, especially if retirement contributions fall into the new "expat tax" threshold.

Neal says this will minimise your tax exposure, as plans like these are exempt from capital gains tax on the initial capital invested, there is no tax on interest earned and there is potentially no estate duty, which makes it an efficient succession planning mechanism.

Expat tax: Financial emigration could cost you - and it's not so simple, experts warn

South Africans working abroad should not opt for financial emigration as a knee-jerk reaction to new expatriate tax laws, cautions Gavin Smith, global financial solutions firm deVere Acuma's head in Africa.

Financial emigration is an exchange control matter whereby a South African can - with the approval of the SA Reserve Bank (SARB) - become classified as a non-resident of the country for tax purposes.

Smith says changing your tax residence status is just one possible option for expats.

Fin24 reported earlier that, due to changes in legislation, South African tax residents working abroad will be required to pay tax of up to 45% on their foreign employment income which exceeds R1m.

This will come into effect as from March 1, 2020 and will include benefits which forms part of the employment package such as travel, housing and even security.

As a result, the option of "financial emigration" has been raised by some tax practitioners and financial advisors.

"Financial emigration, however, does not automatically equate to non-residence. It is not as simple a solution as it seems," cautions Smith.

He explains that, for many South Africans living abroad, financial emigration may mean that they will not be able to achieve their ultimate financial goal of retiring in SA.

Failed emigration
"While this may not seem concerning at present, aspirations change with time and age, as do family circumstances," says Smith.

"Should an expatriate return to SA within five years after financial emigration, the SA Revenue Service (SARS) will deem it a failed emigration and all taxes for that period will be liable."

There is also an inevitable financial burden when one goes from paying no tax at all to paying tax in the currency of the host country.

Furthermore, the exit charge for tax emigration from a capital gains perspective is at a minimum effective rate of 18% on worldwide assets.

In Smith's view, investing in a foreign pension scheme in primary currencies could be an effective option of storing foreign income in a tax efficient way.

He emphasises that these kinds of investments should only be entered into once one has obtained sound financial advice.

According to Hilary Dudley, managing director of specialist wealth manager Citadel Fiduciary, there is currently a lot of misinformation doing the rounds about financial emigration.

She says financial emigration does not necessarily exempt you from paying tax in SA.

"In spite of emigrating, you are still liable to pay tax on any South African-sourced income and may also be found to be tax resident," she says.

"Exchange control residence and tax residence are two different issues, although formal emigration is a way to show the intention to break your tax residence which has a capital gains tax implication."

Like Smith, she too emphasises the importance obtaining the correct advice from a qualified tax practitioner before making any decisions or applications.

She points out that expats who have not been submitting tax returns in SA - although they are still South African tax residents and should have done so - are in debt to SARS and financial emigration will not fix their tax compliance issue in retrospect.