In this issue we take a look at expatriates’ extended tax residence status, South African medical treatment permits, tax on non-resident entertainers and sportspersons, and designing a tax reimbursement policy. In Global News, we discuss developments in Belgium.
New rules welcomed

Extended stay for expatriates

The long-awaited proposed changes to the rules determining an expatriate individual’s tax residence status have now been issued.

The South African Revenue Service (SARS) proposes to extend the period that an individual is taxed as a non-resident from three years to five years. In effect, expatriate individuals will only become resident after five tax years and thus will only be liable for tax on their worldwide income and worldwide capital gains from the beginning of their sixth year of physical residence.

The proposed new rules have been widely welcomed by expatriates and their employers, many of whom have been seeking a change to the rules for some time. In particular, most expatriates will not be faced with a capital gains tax exit charge, as long as the assignment does not extend beyond five years in duration.

Whilst such a positive change is of benefit to expatriates and employers, and thus arguably to the economy as a whole, there remain a number of areas where professional advice should be sought.

Firstly, for those individuals who are considered tax resident on 28 February 2005 (i.e. at the end of the 2005 tax year), the new rules will not be applicable and the three-year residence period remains in place. The existing expatriate population will, therefore, need to be carefully reviewed.

Secondly, in cases of expatriates remaining in South Africa for five years or more, there is a risk that they could become tax resident by virtue of being ordinarily resident. In particular, those expatriates who localise and apply for permanent residence, for example, could be regarded as ordinarily resident and thus tax resident before five tax years have elapsed.

Finally, it should be noted that this legislation remains in draft and whilst it should be applicable with effect from 1 March 2005 (for individuals considered non-resident as at 28 February 2005), the legislation is only expected to become law at the end of this year. You should thus remain in close contact with your professional adviser to monitor the finalisation of the proposed law change and consider the impact on your expatriate population.

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Medical treatment permits

Open road to recovery

What happens if one of your foreign employees is the victim of a gas explosion in Nigeria or a mine disaster in Zimbabwe and there is no immediate medical treatment available for his/her injuries in the relevant country?

It is reassuring to know that a foreigner who is in a critical condition and urgently requires medical attention can enter South Africa without being stopped or questioned at a South African port of entry. With many foreign companies using South Africa as a springboard into Africa, it is usually their best option to fly back their employees who are in need of urgent medical attention. It goes without saying that South Africa’s medical care and services can be rated as one of the best in the world. It is therefore a common occurrence for our ports of entry to deal with these medical emergencies.

The Immigration Amendment Act (Act 19 of 2004) makes provision for a visitor’s permit for medical purposes as well as for a medical treatment permit. The visitor’s permit for medical purposes may only be issued for any period up to three months. On the other hand, a medical treatment permit may be issued to a foreigner intending to receive medical treatment in the Republic for longer than three months.

It is thus reassuring for clients who have business concerns outside the borders of South Africa to know that any foreign employee will be allowed entry into South Africa should there be a medical emergency. This also includes foreign employees who would normally require a visa to enter South Africa.

In most cases a foreign medical doctor will, prior to the patient departing the foreign country, make the necessary arrangements directly with a medical doctor or team in South Africa to be available on the patient’s arrival or, alternatively, South African Immigration officials may also arrange for assistance and an ambulance.

Upon arrival the injured person will be issued with a visitor’s permit for medical purposes, usually for a period of one month. However, this can vary, as each case is dealt with independently. Such permits can in fact be issued for any period up to three months.
If a patient is not in possession of a passport, Immigration will identify a responsible person within the medical team, usually the doctor, who will be given written instruction to gather and submit the documentation of the injured person in order to apply for a passport and to report the foreigner to the Department of Home Affairs within 14 days to apply for the necessary medical visitor’s permit.

To obtain a medical treatment permit, on the other hand, a foreigner must apply for such permit prior to his/her departure for South Africa. Medical treatment permits may be issued for a maximum period of six months. The medical practitioner or medical institution in South Africa must confirm the reasons for and the length and details of the treatment in South Africa. Not to place additional burden on our medical resources, the foreigner must further submit proof of the details of the person or institution responsible for the medical expenses and hospital fees. In this regard, proof of financial means or medical cover will also suffice. In most cases the Department of Home Affairs would require a valid return air ticket or a cash deposit. If a cash deposit is paid, it will be utilised to defray repatriation costs should it become necessary to repatriate the foreigner upon his/her failure to return to his/her country of origin or residence. However, if the foreigner leaves the country within the validity period of his/her permit, the cash deposit will be refunded to the foreigner after his/her final departure.

Once the patient has recovered he/she has to return to his/her country of origin or residence and the permit will not be extended.

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Tax on non-resident entertainers and sportspersons

The new score

*It is a general taxation principle that non-residents are liable for tax in South Africa on their South African-sourced income. Thus, in general, all visiting foreign entertainers and sportspersons are responsible for paying South African tax on earnings for services rendered in South Africa.*

Whilst double taxation agreements can provide exemption from tax for employees and independent contractors, entertainers and sportspersons are specifically excluded from exemption, and are taxable irrespective of the period of time spent in South Africa.

Entertainers and sportspersons often earn large sums of money for relatively short visits to South Africa. Many of the most highly paid are tax exiles from their home countries, often being based for tax purposes in offshore tax havens such as Monaco.

South African exchange controls have made it necessary for taxes to be paid on earnings paid from South Africa in the form of a tax clearance certificate before funds can be paid offshore. However, the mechanism to obtain this certificate was often cumbersome and delays occurred while dealing with the tax authorities. This was due to the fact that the tax on the earnings was computed based on the same rules as for normal taxpayers. In times when the rand was a depreciating currency, the delays experienced often gave rise to significant exchange-rate losses.

Artistes and sportspersons may also be paid significant amounts offshore in addition to local earnings. The taxation of these amounts often depended to a large degree upon the disclosures made by the artiste or sportsperson concerned, especially if they were paid in terms of a separate contract not made available to the South African authorities.

In order to simplify the tax administration relating to artistes and sportspersons, and to help counteract tax evasion, the draft Revenue Laws Amendment Bill introduces a final withholding tax regime on the gross payments to be levied on visiting entertainers and sportspersons, and also introduces substantial reporting requirements on persons that are organising or facilitating events at which foreign artistes and sportspersons will be rendering services in South Africa.

*It is proposed that the tax on non-resident entertainers and sportspersons be a final tax and is to be levied at a flat rate of 15%.*
It is proposed that the tax on non-resident entertainers and sportspersons is a final tax and is to be levied at a flat rate of 15%. A final tax is the final amount of the tax due and will not vary depending upon income levels or available deductions.

Entertainers include any person who performs any activity as a theatre, motion picture, radio or television artiste or a musician. A sportsperson, in turn, is seen to be any person who takes part in any type of sport and would not appear to be limited to professional sportspersons. Supporting personnel who are not part of the performance, such as road crew, tour accountants, etc. will not be subject to the withholding criteria and may also benefit from DTA exemption.

If enacted, the local entity paying the entertainer or sportsperson must withhold the 15% tax from payments. However, should the foreign entertainer be an employee of a South African resident employer, his/her earnings will be subject to employees’ tax at the normal applicable rates and the final tax of 15% will not be imposed. It should also be noted that payments made directly to third parties in respect of the performance in South Africa by the entertainer or sportsperson will also fall within the ambit of the new proposed provisions. This will ensure that the tax is not circumvented by elaborate payment arrangements where payments are made directly to management companies.

Where the resident payer fails to meet this requirement, he/she will be held personally liable for the payment of the amount due. The proposed amendment does, however, provide for the resident payer to recover the amount from the non-resident entertainer or sportsperson.

Whilst the 15% withholding tax will only apply to payments made by a resident of South Africa to the non-resident entertainer or sportsperson, the entertainer or sportsperson will, however, remain responsible for declaring the foreign income to the South African Revenue Service and for paying the final South African tax (15%) thereon.

These provisions will become law on promulgation.

All clients in the entertainment business or sponsors of events, be it on a stage or on the sportsfield, should take note and seek professional tax advice before engaging in their next big act.

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Expatriate compensation packages

Designing a tax reimbursement policy

Most multinational employers have expatriate compensation policies that are designed to ensure that expatriates on overseas assignments receive a compensation package that is comparable to that which they would have earned had they stayed in their home country, taking into account the additional costs of living overseas and foreign taxes.

Generally, a tax reimbursement policy is designed to ensure that the expatriate will not suffer taxes on home and host country income in excess of that which the expatriate would have paid if he were living in his home country. The objective can be accomplished by either applying a tax protection or tax equalisation policy.

An explanation of the two types of tax reimbursement methods is provided below.

The concept of tax protection is that the expatriate will be reimbursed to the extent that his/her combined home and host country taxes exceed the amount that he/she would have paid if living in his/her home country. Where the combined actual taxes are lower because of the foreign assignment (foreign taxes are low or nonexistent in the host country), the expatriate receives a tax benefit in respect of his/her overseas assignment, and he/she is entitled to personally retain the benefit.

A disadvantage of tax protection is that it could influence the preferred location for an assignment. An expatriate will prefer a low-tax foreign country to a high-tax country because of the “tax benefit” that would result. Also, if foreign tax laws change to increase taxation during an expatriate’s assignment (but still below the country tax rates), the loss of the former “benefit” may cause economic
difficulties for the expatriate, even though, in theory, he/she is still better off than had he/she stayed in his/her home country.

Tax protection is most often used by employers with a small work force of expatriates who go to a foreign country for a limited period of time and do not move from one foreign country to another. Effectively, the possibility of a tax benefit is considered an additional incentive for the foreign assignment.

Tax equalisation policies are designed to make taxes a neutral factor in an expatriate’s compensation package. The theory is that all expatriates should continue to incur a tax burden equal to that incurred if they were living in their home country. This holds true regardless of actual tax liabilities under local conditions. From a personnel administration standpoint, this permits other elements of compensation (cost of living and hardship allowances, school fees, etc.) to be determined without regard to taxes. Under this method, any tax benefit resulting from low-tax jurisdictions would be to the employer’s advantage.

Administration of a tax equalisation policy may be more complex than for a tax protection policy. For example, a calculation will always be required to determine the benefit or detriment realised by each expatriate. On the other hand, overall tax savings from expatriates in low-tax countries will offset extra costs incurred by expatriates in high-tax countries.

Generally speaking, when applying a tax equalisation policy, the home-country tax is deducted from the expatriate’s package as a hypothetical tax computed at the beginning of the year (based on the home-country tax system) and reconciled to the need of the year. The host country tax is paid by the company. The expatriate, therefore, receives a package net of tax from the outset and has no further deductions for taxation until the hypothetical tax reconciliation at the end of the year.

Tax reimbursement policies have a significant influence on an expatriate’s compensation package if not properly designed, communicated and administered by the employer. A well-designed plan will also assist the employer to curtail tax reimbursement and administrative costs.

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Following on its success in 2005 Partners in Africa will again be held in South Africa, in March 2006.

PricewaterhouseCoopers tax specialists, as well as guest experts in their field, will be on hand to address relevant tax and other issues.

Clients with interests in Africa should not miss this event.

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13 and 14 March 2006
Emperor’s Palace, Gauteng
Belgium

Belgian tax authorities have revised their interpretation of the so-called “employment article” – article 15 (Dependent Personal Services) of the OECD model tax treaty. In their comments they have also included cross-border income tax issues relating to employee stock option income. Here is how they are likely to apply it in the future.

Background

Article 15 of the OECD Model Convention (the employment article) defines where salaries, derived by a resident of one country in respect of an employment carried out in another country, should be taxed. As a rule, remuneration is taxable in the country where the employment has been carried out. Remuneration will, however, remain taxable in the country of residence of the recipient if the conditions provided by the so-called “183-days rule” are simultaneously met.

Presence in the source country – counting of days

With respect to the counting method of the number of days spent in the source country, the tax authorities differentiate according to whether the “employment article” refers to the “period of activity” or the “period of sojourn”.

If the treaty refers to the “period of activity”, days of normal work interruption (e.g. weekends) spent outside the source country will be counted as spent in the source country to determine whether the threshold of 183 days is exceeded.

When the treaty refers to the “period of sojourn”, it is only the days of physical presence in the source country that will be taken into consideration.

Concept of employer

The Belgian tax authorities now clearly subscribe to the “economical” employer principle. As a result, a person formally employed by a foreign employer but actually carrying out his employment on behalf of and under the supervision of a Belgian company will be regarded as employed by that Belgian company.

“Borne” by a permanent establishment

According to the tax authorities, remuneration can be regarded as borne by a permanent establishment from the moment that it might be deducted from the profits of the permanent establishment, regardless of whether or not such deduction has been effectively claimed.
Stock option income

The Belgian tax authorities have also included comments on how they intend to address cross-border tax issues arising from employee stock options. Their guidelines are grounded in those of the OECD.

In short, the Belgian tax authorities will consider income derived from the exercise or the alienation of the options that fall under the “employment article”. Unconditional options will be considered to be sourced to the country where the recipient is taxed on employment income when the options were granted.

Options subject to a vesting period will be sourced based on workdays from grant to vesting. However, in the vast majority of the cases, Belgium would first tax the options as if they were from Belgian source and would only grant tax relief for the portion of stock option income sourced to another country when the options are eventually exercised. Surprisingly, if the options were not to be exercised, the Belgian tax that the individual would have paid at grant would be final.

The Belgian tax authorities have aligned their interpretation more closely with the guidelines of the OECD, which include the sourcing-principle. However, the Belgian tax authorities’ view with respect to how and when tax relief on stock option income should be granted is expected to be debated.

Global News articles are sourced from IAS Global Watch, a PricewaterhouseCoopers publication.

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