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Potential Emigrants, Beware

Legal Brief
November 2020

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Currently, the Income Tax Act, 1962 (the Act) allows for the payment of a lump sum benefit to a member of pension, pension preservation, provident, provident preservation or retirement annuity funds (as defined in section 1 of the Act), when such member withdraws a lump sum as a consequence of his or her emigration from South Africa. Importantly, the member's emigration must be recognised by the Financial Surveillance Department of the South African Reserve Bank (SARB) for exchange control purposes, before the lump sum benefit can be paid. Other than in the case of a provident fund, it is generally not possible to withdraw more than one-third of the fund value as a lump sum.

Amendments to the Exchange Control Regime

On 26 February 2020, Finance Minister Tito Mboweni delivered his National Budget Speech and made the noteworthy announcement that National Treasury intend to modernise and relax the current Exchange Control Regulations (to take effect on 1 March 2021, although this might be delayed owing to the effect of the lockdown). One of the proposed changes was to phase out the concept of an exchange control emigrant, ultimately treating natural person emigrants and natural person residents identically under the new regime.

Naturally, the definition of pension, pension preservation, provident, provident preservation and retirement annuity funds (as defined in section 1 of the Act) would need to be amended to ensure harmony between the permissibility of a member of a retirement fund to receive a lump sum benefit when such member is recognised as an emigrant by SARB, and the fact that the concept of an exchange control emigrant would no longer exist with effect from next year.

Taxation Laws Amendment Bill, 2020

On 31 July 2020, the Draft Taxation Laws Amendment Bill, 2020 (Draft TLAB 2020) was released, which proposed that the test for a lump sum payment to be made from a retirement fund to a member be amended with effect from 1 March 2021.

Specifically, the test would no longer be that the member must first be recognised as an emigrant by SARB, but rather that the member would have to have ceased to be South African tax resident, and remain non-resident for a period of three years, before the lump sum payment could be made.

Although this proposed amendment might to some seem reasonable on the face of it, it brings with it a host of practical issues including:

> whether or not the three year period refers to a tax year or a calendar year;

> the fact that the new test is more onerous on a taxpayer as it requires the taxpayer to prove that that he or she has been non-resident for three years (as opposed to merely submitting an emigration application to SARB, and having it approved, which is a purely formalistic process which takes much less than three years to complete); and

> the fact that many emigrants require the amounts from their retirement funds to pay for the costs of moving to, and settling in, their new countries of residence (the new test is thus more financially burdensome on a taxpayer as he or she now has to wait three years before receiving the lump sum payment).

The above issues were all raised with National Treasury when the Draft TLAB 2020 was opened for public comment.

Draft Response Document

On 13 October 2020, National Treasury released the Draft Response Document, which dealt with the issues listed above (although not as adequately as one would hope), as follows:

> there was no response to whether or not the three year test refers to a tax year or calendar year;

> National Treasury responded that the new test is not more onerous on a taxpayer as the residency rules apply as they have in all other cases, been guided through SARS Interpretation Note 3 dealing with the residence of an individual (although the tax residence of the individual was clearly never a criterion and only approval by the SARB for exchange control emigration was the test); and

> National Treasury responded that Government did not intend to provide a tax incentive for funds to be used for emigration and that they are now trying to achieve a horizontal equity point as tax residents who decide not to emigrate have to wait to retirement for withdrawals from retirement annuity funds (although this somewhat ignores the question of whose savings these funds comprise and who was the person who worked jolly hard to accumulate these savings).

Conclusion

National Treasury's responses have, unfortunately, left us with more questions than answers. What is clear is that the new test for the withdrawal of a lump sum from a retirement fund will be more burdensome on a member of a retirement fund (both financially and from an evidentiary perspective).

In conclusion, if one is in a position to emigrate under the current exchange control regime (and consequently be permitted to withdraw a lump sum from one's retirement fund), one should do so. The Draft Response Document did indicate that an amendment would be made to the effect that the current dispensation would still be granted to an applicant whose emigration forms had been submitted to SARB by the end of February 2021, despite the emigration not yet being approved.

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