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New Tax Court case on source

Why this matters?

A recent tax court judgment substantially deviates from the principle emanating from case law to-date. Our courts have consistently maintained that the source of employment income is located at the place where the services are rendered.

This is also the predominant principle applied internationally. It appears from the judgment that to apportion income for services rendered outside of South Africa, one would need to show foreign employment in relation to that income by way of an employment contract with the foreign employer.

It is however, important to note that this is a judgment of the Tax Court and will be superseded by case law of higher courts, for example the SCA decision of the Lever Brothers case. However, this judgment could serve as an indication of the principle that may be applied by SARS in the future. In this regard, SARS has indicated that it is still evaluating the impact of the judgment. SARS has also confirmed that guidance cannot be provided with regard to the meaning of "casual and accidental" or "subsidiary and incidental" referred to in its Guide on the Taxation of Foreigners Working in South Africa (2014/15), as this will depend on the facts and circumstances of each case.

In view of the above, before apportioning the remuneration of non-resident expatriate employees to exclude the portion relating to services rendered outside of South Africa, employers should consider various factors to determine whether these services could be regarded as incidental to the employee's duties in South Africa. Where this is the case, the remuneration earned for these services will be taxable in South Africa. Having a foreign employment contract for these services will certainly work in their favour.

The Detail

Non-resident Foreign nationals seconded temporarily to South Africa are sometimes required to render services outside of South Africa during their secondment period. These expatriate employees will travel abroad from time to time to render these services, which are not necessarily the same services rendered to the South African entity.

Furthermore, expatriate employees do not generally receive additional remuneration for these services. However, these additional services are in all likelihood taken into account when determining their remuneration during the secondment period.

South African legislation allows for the taxation of South African sourced income in the hands of non-residents. Our courts have consistently maintained that the source or originating cause of income from employment and other services rendered, is the service itself, irrespective of the place where the contract is concluded or the remuneration is paid.

Based on this principle, remuneration relating to days spent working in South Africa is regarded as South African sourced income, whereas remuneration relating to days spent working outside of South Africa has historically been regarded as foreign sourced income.

Over the years the South African Revenue Service ("SARS") has from time to time challenged the source of income in the hands of a non-resident expatriate employee. SARS has stated in its *Guide on the Taxation of Foreigners Working in South Africa (2014/15)* that if the services rendered outside of South Africa by the non-resident are merely "*casual and accidental, or subsidiary and incidental"*, then the source of the employment income will be fully South African.

Further to the above, in the recent Income Tax Case No. 14218 (judgment delivered on 9 March 2018), the court held that the originating cause or source of the disputed income was the contract of employment (entered into in South Africa), and not the place where the services were physically rendered i.e. jurisdictions outside of South Africa.

The details of this case are as follows:
The taxpayer was a US tax resident working in South Africa for a branch of a US company. The court held that the 62 days of service that the Appellant rendered outside of South Africa during the 2014 tax year, were "consequential contractual obligations" rendered to the Appellant's South African employer, and not to the individual recipients of his services in other countries. The court accordingly held that the income was South African sourced and subject to tax in South Africa.

The grounds for the judgment were, *inter alia*, as follows:

- the rendering of the services was no more than reciprocal performance by the taxpayer to a South African employer;
- the source of the income during the 62 day period was no different to the source of the income earned for services rendered in South Africa.

The court further held that there are five factors to consider in determining the place where employment is exercised, as follows:

- What the contract itself stipulates concerning the law governing it;
- Where the contract was concluded;
- Who is paying the employee;
- Who the services are being rendered to; and
- Where the services are being rendered.

This goes against historic interpretation, and prevailing practice, and will no doubt be challenged in a higher court in future. It does however give SARS ammunition to challenge foreign-sourced income and tax this income in South Africa.

We can expect to see more challenges than we have seen in the past, as a result.

For more information, please contact:

Cecelia Madden
Associate Director, Global Mobility Services & Employment Tax Advisory
KPMG SA
M:+27 (0)82 719 5658
E: cecelia.madden@kpmg.co.za

Zaheera Moosa
Tax Manager, Global Mobility Services & Employment Tax Advisory
KPMG SA
M:+27 (0)82 719 5411
E: zaheera.moosa@kpmg.co.za
