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INCOME TAX

Double taxation, lump sums, and annuities

Add emigration into the mix, and the concepts seem somewhat unclear

By: STEVEN JONES

DOUBLE TAXATION—these two words are like waving a matador's cape in front of an angry bull. To be honest with ourselves, being taxed once on a particular income stream is galling enough, but being taxed twice is enough to make even the most patriotic taxpayer begin to question their loyalties.

I hate to be the bearer of bad news, but the reality in most tax jurisdictions is that one's income is not only taxed once, but often twice, three times, or even more.

Don't believe me? Let's look at the proverbial Joe Soap example. Joe earns a salary. His employer deducts employees tax (PAYE) and pays this over to SARS. With the amount that Joe has left in his account, he needs to pay bills and clothe and feed his family. Many of these bills have VAT levied on them.

Joe also needs a vehicle to get around, and the purchase price of said vehicle includes import duty, carbon emissions tax, and VAT. The vehicle also needs to be licenced (more tax), insured (with VAT thereon), and fuelled (with a significant portion of each litre being a tax component). He also has the misfortune of living in greater Johannesburg, which means e-tolls (which also attract VAT—talk about tax on tax!).

Now Joe recognises that even with his budget being as tight as it is (especially after paying all these taxes), so he saves like crazy for a deposit on a house. However, before he even gets the key to his new home, he is faced with legal fees (which, once again, attract VAT) and transfer duty on the purchase price. Once he has taken transfer of the property, the municipality hits him for rates (another tax!). Then, if he decides to sell the house, heaven forbid if he should make a profit—if he has bought in a good area and has kept the house long enough, he could find that his substantial profit falls into the Capital Gains Tax net.

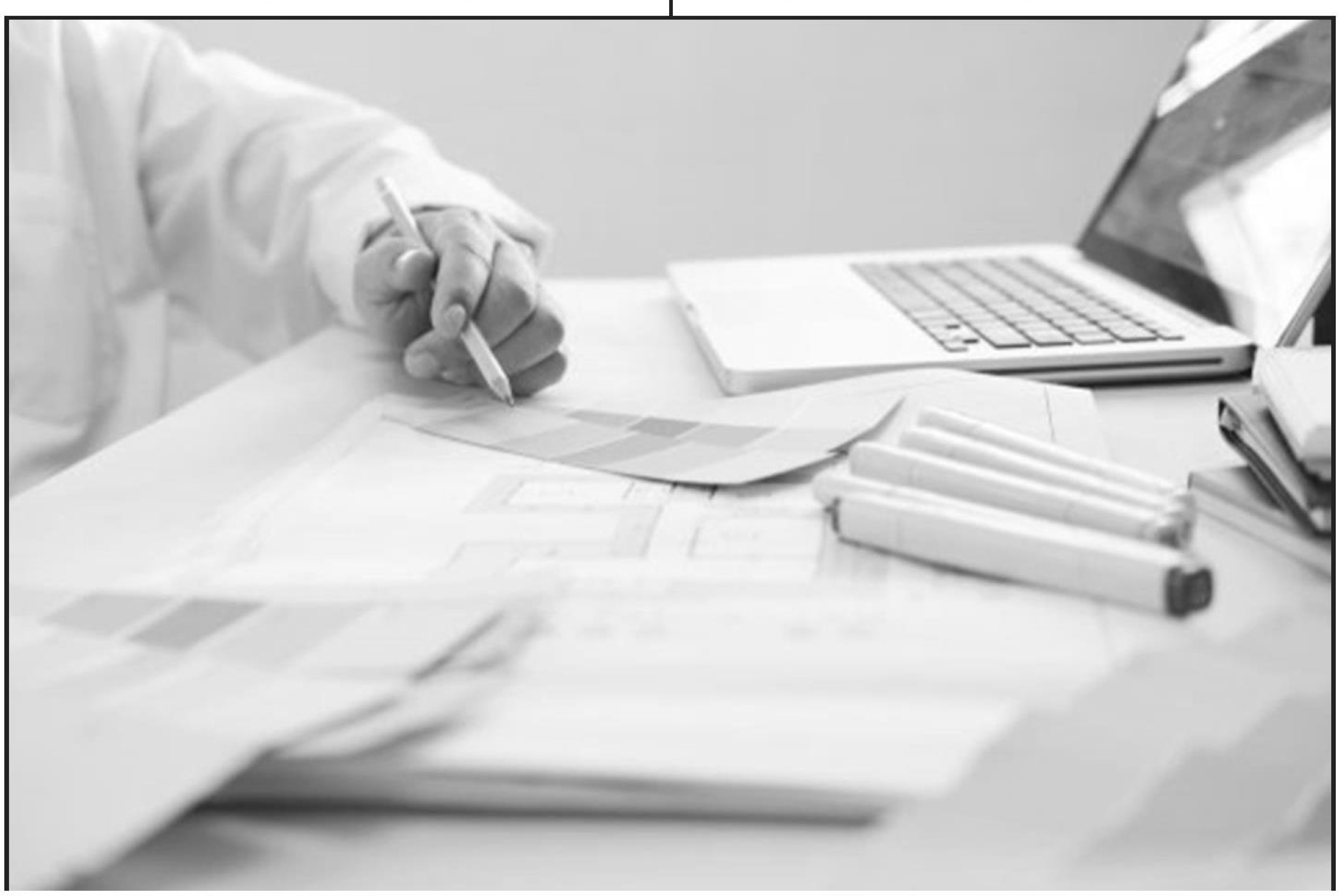
So spare a thought for the reader who became non-resident in 1981 when he emigrated to Spain. He continued to fund his retirement annuity until 2012 when it matured, then withdrew the funds (after the withdrawal tax was paid), had them paid into his non-resident 'blocked account' in SA, from where they were transferred to Spain.

These net proceeds were used to purchase an annuity in Spain, and the resultant annuity payments were taxed as income by the Spanish tax authorities. The reader questioned this practice, arguing that since the proceeds of the RA had already been taxed in South Africa, paying tax to the Spanish authorities amounted to double taxation.

Gavin Butchard, finance director of Brenthurst Wealth, provided the following answer:

The reader stated that they had formally emigrated and have been a tax resident offshore for some time, however they continued to contribute to their South African Old Mutual retirement annuity (RA), from already-taxed offshore income.

From a South African point of view, RAs provide individuals with an option to save for retirement in



their personal capacity, while provident and pension funds are offered and administered by employers to employees. RAs are generally paid by taxpayers directly, using after-tax income and claimed as a deduction in their annual South African income tax returns, which are subject to the prevailing tax limits.

At retirement age you have the option to then retire from the fund, commute up to one-third of the fund value taxed according to the retirement tax tables with the remainder used to purchase an annuity, which would then be taxed at source according to the individual's marginal tax rate.

Unfortunately, when non-resident taxpayers elect to commute the full amount with regard to a retirement annuity, the withdrawal tax tables are applied.

Non-resident taxpayers are usually only subject to South African tax on their income from sources within South Africa. If a non-resident member elects to leave the benefit in South Africa and purchase an annuity at retirement, then the annuity will be taxed at the member's marginal tax rate. However, the non-resident can elect to apply for a directive for relief in respect of withholding tax from their annuity income.

The purpose of the double taxation agreements between the two countries is to enable the administrations to eliminate double taxation, and to prevent tax evasion by providing for the exchange of information between the countries. The lump-sum withdrawal was therefore taxed in South Africa, and current annuity withdrawals are taxed in Spain.

Important to note is that 'double taxation' in the context of a Double Tax Treaty (DTT) between countries is to avoid a situation where the same income is taxed in both jurisdictions.

For example, if one were to assume that the taxpayer in this case had not formally emigrated and was still a South African 'resident' for tax purposes, he would have been liable to SARS for tax on his worldwide income. This would have meant that his Spanish annuity would have become liable to withholding tax in Spain, and also been subject to South African tax.

In the above example, the purpose of the DTT would be to determine either which jurisdiction would have authority to tax this income, or alternately, to provide for relief in either jurisdiction for the tax paid to the other jurisdiction.

In the absence of a DTT, the default position in South Africa is that the income will be subject to SA tax, but a tax credit will be allowed for tax paid to the foreign jurisdiction. However, such credit

Table 4.5 Personal income tax rates and bracket adjustments

2017/18 Taxable income (R)	2017/18 Rates of tax	2018/19 Taxable income (R)	2018/19 Rates of tax
R0 - R189 880	18% of each R1	R0 - R195 850	18% of each R1
R189 881 - R296 540	R34 178 + 26% of the amount above R189 880	R195 851 - R305 850	R35 253 + 26% of the amount above R195 850
R296 541 - R410 460	R61 910 + 31% of the amount above R296 540	R305 851 - R423 300	R63 853 + 31% of the amount above R305 850
R410 461 - R555 600	R97 225 + 36% of the amount above R410 460	R423 301 - R555 600	R100 263 + 36% of the amount above R423 300
R555 601 - R708 310	R149 475 + 39% of the amount above R555 600	R555 601 - R708 310	R147 891 + 39% of the amount above R555 600
R708 311 - R1 500 000	R209 032 + 41% of the amount above R708 310	R708 311 - R1 500 000	R207 448 + 41% of the amount above R708 310
R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000	R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary	R13 635	Primary	R14 067
Secondary	R7 479	Secondary	R7 713
Tertiary	R2 493	Tertiary	R2 574
Tax threshold		**Tax threshold**	
Below age 65	R75 750	Below age 65	R78 150
Age 65 and over	R117 300	Age 65 and over	R121 000
Age 75 and over	R131 150	Age 75 and over	R135 300

Source: National Treasury

will be limited to the South African tax liability on such income. For example, if the foreign jurisdiction had deducted R5 000 in tax but the liability on such income in SA would have only been R4 500, the credit for the foreign tax deducted will be limited to the R4 500. In other words, the net effect is that the income tax liability would be that of the jurisdiction with the higher tax rate.

In the case of the taxpayer who had commuted his RA and then used the after-tax proceeds to purchase an annuity, we are dealing with two different forms of income—the proceeds of the RA itself (taxed according to the withdrawal tables in this case), and the income arising from the purchased annuity. They are not the same income, and as Butchart stated, it is therefore correct for SA to have taxed the RA proceeds and for Spain to have taxed the annuity income.

Bear in mind, however, that the scenario above may be treated differently where other countries are involved, and reference would need to be made to the specific DTT between South Africa and the country concerned (or the 'general rule' in the absence of a DTT). This is an area where appropriate professional tax advice is critical.

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