**DRAFT INTERPRETATION NOTE: NO. 16 (Issue 2)**

DATE:

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| **ACT** | **:** | **INCOME TAX ACT NO. 58 OF 1962** |
| **SECTION** | **:** | **SECTION 10(1)(*o*)(ii)** |
| **SUBJECT** | **:** | **EXEMPTION FROM INCOME TAX: FOREIGN EMPLOYMENT INCOME** |

***Preamble***

In this Note unless the context indicates otherwise –

- **"Republic"** and **"South Africa"** are used interchangeably as a reference to the sovereign territory of the Republic of South Africa, as defined in the definition of "Republic" in section 1(1);
- **"Schedule"** means a Schedule to the Act;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

## 1. Purpose

This Note discusses the interpretation and application of the foreign employment remuneration exemption in section 10(1)(*o*)(ii).

## 2. Background

The requirements to qualify for the exemption, which are set out in section 10(1)(*o*)(ii), are discussed in this Note. The correct method of apportionment is also examined, as well as how the exemption affects gains included in income upon the vesting of any equity instrument under section 8C.

The terms of tax treaties vary from treaty to treaty, and so the possible effects of tax treaties are not discussed in this Note.

## 3. The law

### Section 10(1)(*o*)(ii)

> **10. Exemptions**—(1) There shall be exempt from normal tax—
>
> (*o*) any form of remuneration—
>
> (i) …

(ii) received by or accrued to any employee during any year of assessment by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, including any amount referred to in paragraph (*i*) of the definition of gross income in section 1 or an amount referred to in section 8, 8B or 8C in respect of services rendered outside the Republic by that employee for or on behalf of any employer, if that employee was outside the Republic—

(*aa*) for a period or periods exceeding 183 full days in aggregate during any period of 12 months; and

(*bb*) for a continuous period exceeding 60 full days during that period of 12 months,

and those services were rendered during that period or periods: Provided that—

(A) for purposes of this subparagraph, a person who is in transit through the Republic between two places outside the Republic and who does not formally enter the Republic through a port of entry as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act, shall be deemed to be outside the Republic;

(B) the provisions of this subparagraph shall not apply in respect of any remuneration—

(AA) derived in respect of the holding of a public office contemplated in section 9(2)(*g*); or

(BB) received by or accrued to any person in respect of services rendered or work or labour performed as contemplated in section 9(2)(*h*); and

(C) for the purposes of this subparagraph, where remuneration is received by or accrues to any employee during any year of assessment in respect of services rendered by that employee in more than one year of assessment, the remuneration is deemed to have accrued evenly over the period that those services were rendered;

## 4. Application of the law

### 4.1 Qualification criteria for the exemption

In order to qualify for the exemption, a taxpayer must –

- earn certain types of remuneration;
- in respect of employment; and
- in respect of services rendered;
- outside the Republic;
- during specified qualifying periods; and
- not be subject to an exclusion.

These requirements are analysed and interpreted below.

### 4.1.1 Remuneration

Not all remuneration[1] qualifies for exemption under section 10(1)(*o*)(ii). The remuneration that qualifies is remuneration received by or accrued to an employee "by way of" the following amounts, namely, salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument or allowance, for services rendered. Amounts contemplated in paragraph (*i*) of the definition of "gross income" in section 1(1) are also included,[2] as too are amounts referred to in section 8,[3] 8B[4] or 8C.[5]

The exemption relates to remuneration received or accrued for services that were rendered outside the Republic (see **4.1.4**) during the qualifying periods (see **4.1.5**). Periods outside the Republic where no remuneration was earned fall outside the ambit of section 10(1)(*o*)(ii).

Remuneration received by or accrued during a qualifying period for services rendered ***within*** South Africa <u>does not qualify for exemption</u>. Remuneration earned during a qualifying period in respect of services that were rendered both inside and outside of South Africa must be apportioned (see **4.2**) so that only the income relating to foreign services is exempt.

### 4.1.2 Employment relationship

The exemption under section 10(1)(*o*)(ii) only applies if an employment relationship exists. The services that are rendered for or on behalf of the employer must be rendered under an employment contract.

The term "any employer" means that services rendered to resident or non-resident employers could qualify for exemption.

The term "employee"[6] is not defined in the main body of the Act, and so must be given its ordinary meaning. An "employee" under the common law excludes an independent contractor or self-employed person.[7] Directors in their capacity as directors are holders of an office, not employees, and to the extent that they earn directors' fees, such fees do not qualify for exemption under section 10(1)(*o*)(ii).

### 4.1.3 Services rendered

The remuneration must be received in respect of services rendered. Amounts payable by an employer to an employee, but which do not relate to services rendered, are not included in the scope of the exemption. Payments for the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment or of any appointment (or right to be appointed) to an office or

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[1] The term remuneration is not "remuneration" as defined in the Fourth Schedule.

[2] The cash equivalent of the value of any taxable benefit as calculated under the Seventh Schedule; and the amount of any gain made by the exercise, cession or release of a right to acquire a marketable security, under section 8A.

[3] In the context of section 10(1)(*o*)(ii), this refers to allowances, advances and reimbursements under section 8(1).

[4] Taxation of amounts derived from broad-based employee share plans.

[5] Taxation of directors and employees on vesting of equity instruments. See **4.3**.

[6] The definition of "employee" in paragraph 1 of the Fourth Schedule is not applicable.

[7] See Interpretation Note No. 17 (Issue 3) dated 31 March 2010 "Employees' Tax: Independent Contractors" for a discussion on employees and independent contractors under the common law.

employment[8] are received by virtue of such termination, loss, repudiation, cancellation or variation, not in respect of services rendered, and are accordingly not exempt under section 10(1)(*o*)(ii).

### 4.1.4 Outside the Republic

In order to qualify for exemption, the services must be rendered "outside the Republic". The term "Republic" is defined in section 1(1).[9] The definition encompasses the landmass of South Africa as well as its territorial waters,[10] which is a belt of sea adjacent to the landmass but not exceeding 12 nautical miles (roughly 22,2km) beyond the baselines[11] of the country.

In certain circumstances, the Republic may extend beyond the geographical limits of its landmass and territorial waters. The definition of "Republic" specifically includes those areas beyond the territorial sea which have been designated under international or domestic law as areas where South Africa may exercise sovereign rights in respect of the exploration or exploitation of natural resources. This definition is aligned with domestic law[12] and international law,[13] which provide for South Africa's right to explore and exploit natural resources in the exclusive economic zone[14] and on the continental shelf.[15]

The exclusive economic zone extends to 200 nautical miles (roughly 370,6km) from the baselines.[16] The continental shelf extends to the outer edge of the continental margin, or 200 nautical miles from the baselines, whichever is the greater.[17]

These are factors that must be considered when determining whether a person renders services in the Republic or outside of the Republic, for purposes of section 10(1)(*o*)(ii). Remuneration for services rendered beyond South Africa's territorial seas but within the exclusive economic zone or on the continental shelf will not qualify for exemption under this section if the person's employment services relate to the exploration or exploitation of natural resources.

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8 That is, amounts contemplated in paragraph (*d*)(i) of the definition of "gross income" in section 1(1).

9 "*[T]he Republic of South Africa and, when used in a geographical sense, includes the territorial sea thereof as well as any area outside the territorial sea which has been or may be designated, under international law and the laws of South Africa, as areas within which South Africa may exercise sovereign rights or jurisdiction with regard to the exploration or exploitation of natural resources;*"

10 Defined in section 4 of the Maritime Zones Act No. 15 of 1994 (MZA). This definition is aligned with what constitutes a state's territorial sea under international law, specifically Articles 2 and 3 of the United Nations Convention on the Law of the Sea (UNCLOS), signed by South Africa on 5 December 1984 and ratified on 23 December 1997.

11 Defined in section 2 of the MZA and Article 3 of UNCLOS.

12 Section 7 of the MZA.

13 Section 233 of the Constitution of South Africa, 1996 provides that a court must prefer an interpretation of domestic legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.

14 Article 56(1)(a) of UNCLOS deals with a state's "exclusive economic zone" and provides that a coastal state has "*…sovereign rights for the purpose of exploring and exploiting…the natural resources, whether living or non-living, of the waters superadjacent to the seabed and of the seabed and its subsoil…*"

15 Article 77(1) of UNCLOS provides that a "*…coastal State exercises over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources.*" In view of this provision, it is unnecessary to consider for purposes of this Note whether the continental shelf forms part of South Africa's territory under customary international law.

16 Section 7 of the MZA and Article 57 of UNCLOS.

17 Section 8 of the MZA and Article 76(1) of UNCLOS.

### 4.1.5 Days test

*Period or periods exceeding 183 full days in aggregate*

In order to qualify for the exemption, a person must be in employment, outside the Republic, for at least 183 full days during any 12-month period. A “full day” means 24 hours (from 0h00 to 24h00). The 183 full days do not have to be consecutive or continuous but, in order to meet the exemption requirements, a total of 183 full days in any 12-month period must be exceeded. It is not necessary to exceed this period by a full day. Any amount of time in excess of 183 full days, such as a few hours, will be sufficient.

Calendar days must be looked at, not only work days, when calculating whether a person has been outside the Republic for 183 full days.

Weekends, public holidays, annual leave days, sick leave days and rest periods (as required under the specific terms of a contract of employment) that are spent <u>outside</u> South Africa are taken into account for purposes of calculating the period or periods outside South Africa.

**Note:** The rules applicable to qualifying days for apportionment of income are different to the rules to calculate whether the 183-day or 60-continuous-day tests have been met (on apportionment, see **4.2**).

A distinction must be made between a situation where a person is in employment and is actually outside of South Africa but is not physically rendering services, and a situation where a person is physically present outside of South Africa but is not in employment. Section 10(1)(*o*)(ii) clearly links the days test to the person’s employment. Days spent outside of South Africa when a person is not in employment do not qualify as days outside of South Africa under section 10(1)(*o*)(ii), and are thus not taken into account in the determination of the 183 days for purposes of the exemption. Such broken periods of employment may arise if an employee is employed at intervals. An employee may, for example, be employed on a contract basis and enter into separate employment contracts for each broken period of employment. The time in-between the contracts where the employee is unemployed and where no services are rendered do not qualify under section 10(1)(*o*)(ii) as days outside the Republic.

Conversely, employees who remain in employment whilst outside of South Africa, but only render services for specified periods and then have rest periods, will be able to claim the rest period days as days outside South Africa for purposes of the days test. A common example is where employees work rotational shift periods, such as a specified number of days rendering services followed by an equal number of days of rest. Such rest periods are often required by local health and safety legislation. The rest periods do not interrupt continuous employment, and such days are accepted as falling within the scope of the days test.

*Continuous period exceeding 60 full days*

In addition to the requirement that services must have been rendered outside South Africa for a period or periods exceeding 183 full days in aggregate during any period of 12 months, a person must also have rendered services outside South Africa for a continuous period exceeding 60 full days in the same period of 12 months. For example, if a period of 12 months from 1 April 2013 to 31 March 2014 is used to calculate whether the person spent a period or periods exceeding 183 full days in aggregate outside South Africa, that same period of 12 months must be used to determine whether the person spent a continuous period exceeding 60 full days outside South Africa.

To exceed a continuous period of 60 full days does not mean that it must be exceeded by a full day, but by any amount of time, even if this amounts to, for example, a few minutes or hours.

Taxpayers must be in a position to substantiate their absences from South Africa and that the absences were under an employment contract and to render services, and may thus be required to provide some form of documentation when claiming the exemption.[18] This documentation may include, without limiting the scope of what could be requested by SARS, letters of secondment, employment contracts for foreign services and copies of passports. This documentary proof will assist in the verification of the period or periods worked outside South Africa.

*During any period of 12 months*

The remuneration that is exempted by this provision relates to amounts earned from services rendered outside the Republic, if the days tests were met during "any period of 12 months".

The word "month" is not defined in the main body of the Act.[19] Section 2 of the Interpretation Act[20] provides that, unless the context otherwise requires, the word "month" in any law means a "calendar month". Under dictionary meanings, a calendar month could mean either one of the twelve named portions into which a calendar year is divided, or it could mean a period of time which is calculated from a date in one month to the same date in a successive month.[21]

In *Subbulutchmi v Minister of Police and Another*,[22] James JP stated the following:[23]

> "According to the Interpretation Act 33 of 1957 a month means a calendar month. In the absence of any clear indication to the contrary to be found in the words used in any particular legislation a calendar month running from an arbitrary date expires with the day in the succeeding month immediately preceding the day corresponding to the date upon which the period starts. Thus, if a calendar month commences on the 10th of one month it will expire at the end of the 9th day of the succeeding month."

There are no clear indications in the context of section 10(1)(*o*)(ii) that the more restrictive meaning of a named calendar month was intended. The contextual factors in fact point the other way – the use of the word "any" prior to the words "period of 12 months" indicates that the meaning should be extended rather that restricted.

The period of 12 months referred to in section 10(1)(*o*)(ii) must therefore be given the more extended meaning and does not need to commence on the first day of a named calendar month or end on the last day of a named calendar month.

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18 Section 46(4) of the Tax Administration Act No. 28 of 2011.

19 The definition of "month" in paragraph 1 of the Fourth Schedule is not applicable.

20 No. 33 of 1957.

21 Concise Oxford English Dictionary. Edited by Catherine Soanes, Angus Stevenson. 11th ed. rev. New York: Oxford University Press, 2006; Collins English Dictionary. 3rd Edition Glasgow: Harper Collins, 1991.

22 1980 (3) SA 396 (D); subsequently approved by the Appellate Division in *Minister of Police v Subbulutchmi* 1980 (4) SA 768 (A).

23 At page 397 F-G.

The period or periods exceeding 183 full days mentioned above must fall within a period of 12 consecutive months. The period of 12 months is not necessarily a year of assessment, a financial year, or a calendar year; it is **any** period of 12 consecutive months.

*Practical application*

In identifying a period of 12 months that may be used, the period during which the services were rendered to the employer should first be identified. A useful point to commence the enquiry would be by looking from the first day of the month in which remuneration from foreign services was received or accrued, and then working forward 12 months to determine whether the 183- and-60-continuous-full-days were met. If so, that is the end of the enquiry and the foreign remuneration will be exempt. If the days tests are not met, the last day of the month in which foreign remuneration was earned can be looked to, and then by working backwards 12 months.

This is not an either/or approach. A person is entitled to look both forwards and backwards over any period of 12 months, meaning that some periods may overlap. If the first month in this test does not yield 183- and-60-continuous-full-days, the following month can be looked to, and worked forward or backwards – meaning that the prior month that was looked at first, will be taken into account again in assessing whether the days test was met for the second month. The multiple use of any specified period is permitted due to the wording of the section that permits the test to be conducted over "any" period of twelve months.

Although the first or last day of a month, and a full month, is used in the explanation above, that is simply for illustrative purposes. Because a 12-month period can commence or end on any day in the month, the 12-month period could commence, for example, on the 12$^{th}$ of a month and end on the 11$^{th}$ of that month the following year. The test could also apply on a daily basis, not monthly.

**Example 1 – Meeting the requirements for a qualifying period**

*Facts:*

X was seconded by a South African holding company to a subsidiary in Australia for the period 1 March 2014 to 30 September 2014 (seven months). An employment contract was entered into stipulating X would be remunerated by the South African holding company and that X would not, under any circumstances, return to South Africa during the period of the secondment. X did not, in fact, return to South Africa during this period.

*Result:*

X was employed and rendered services outside South Africa for a continuous period of 214 days. According to the filtering process of the flow diagram in the **Annexure**, it is clear that X is entitled to the exemption under section 10(1)(*o*)(ii), as X meets both the 183- and 60-continuous-day rule requirements.

*Persons in transit through South Africa*[24]

A person is deemed to be outside South Africa where such a person is in transit between two places outside South Africa and –

- the person does not formally enter South Africa through a port of entry as contemplated in section 9(1) of the Immigration Act, No. 13 of 2002; or
- the person does not formally enter South Africa at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs under the Immigration Act.

This means that the point of departure and the point of destination of the journey that is being undertaken must be outside the borders of the Republic (see **4.1.4**).

### 4.1.6 Exceptions[25]

Two categories of employee are expressly excluded from the exemption. Remuneration derived from the holding of a public office, as contemplated in section 9(2)(*g*), does not qualify for exemption. The public office holder must be appointed or deemed to be appointed under an Act of Parliament.[26]

Remuneration derived from services rendered or work or labour performed for or on behalf of an employer under section 9(2)(*h*) also does not qualify for exemption. These persons include employees of employers in the national, provincial or local sphere of government, certain constitutional institutions, national and provincial public entities listed in Schedules 2 and 3 of the Public Finance Management Act,[27] and municipal entities.[28]

## 4.2 Apportionment of remuneration

A common misconception is that all remuneration received or accrued during the qualifying period of 12 months is exempt. This is incorrect. Only the remuneration received or accrued *in respect of services rendered outside the Republic during the qualifying period of 12 months is exempt*. Remuneration received or accrued during a qualifying period of 12 months **in respect of services rendered within South Africa remains subject to tax in South Africa**. Once a person has met the 183- and 60-days tests under section 10(1)(*o*)(ii), the portion of the remuneration that qualifies for the exemption under section 10(1)(*o*)(ii) must be calculated.

Remuneration received or accrued by any employee relating to services rendered in more than one year of assessment, is deemed to have accrued evenly over the period during which the services were rendered.[29] An example could be a bonus that accrues in one year but in relation to services rendered in both the current and the previous year; or a gain included in income under section 8C (see **4.3** and **Example 4**).

[24] Proviso (A) to section 10(1)(*o*)(ii).
[25] Proviso (B) to section 10(1)(*o*)(ii).
[26] Under section 9(2)(*g*).
[27] No. 1 of 1999.
[28] As defined in section 1 of the Local Government: Municipal Systems Act No. 32 of 2000.
[29] Proviso (C) to section 10(1)(*o*)(ii).

SARS accepts the following as the correct method to calculate the exempt portion of remuneration:

> $$\frac{\textit{Work days outside South Africa for the period}}{\textit{Total work days for the period}} \times \textit{Remuneration received during the period}$$
>
> *= Exempt portion of remuneration*
>
> *"Work days" do not include weekends, public holidays or leave days. Only days of actual services rendered are taken into account. A "period" refers to the full period during a year of assessment over which a taxpayer is required to render services outside South Africa.*

Remuneration received for services rendered during work days in South Africa is subject to normal tax in South Africa and is excluded from the above formula.

**Example 2 – Apportionment of income**

*Facts:*

Z is employed by the South African subsidiary of a multi-national company. Due to specialised knowledge, Z was requested to assist a New Zealand subsidiary and left South Africa on 1 May 2014 to commence work on 2 May 2014. Z was contracted to work in New Zealand until 19 December 2014. The subsidiary company in New Zealand remunerated Z during this period. Z departed New Zealand on 20 December 2014 to return to South Africa.

Z returned to South Africa to fulfil local employment obligations during the following periods, which include travel days:

- 22 June 2014 to 6 July 2014;
- 30 August 2014 to 7 September 2014; and
- 11 November 2014 to 20 November 2014.

*Result:*

The number of calendar days during which remuneration was derived from services rendered in New Zealand in the 2015 year of assessment is as follows:

| | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | **TOTAL** |
|---|---|---|---|---|---|---|---|---|---|
| 2 May 14 to 21 June 14 | 30 | 21 | | | | | | | 51 |
| 7 July 14 to 29 Aug 14 | | | 25 | 29 | | | | | 54 |
| 8 Sept 14 to 10 Nov 14 | | | | | 23 | 31 | 10 | | **64** |
| 21 Nov 14 to 19 Dec 14 | | | | | | | 10 | 19 | 29 |
| | | | | | | | | | **198** |

The total remuneration that Z received for services rendered during the period 2 May 2014 to 19 December 2014 is R500 000.
As the table above indicates, the taxpayer satisfies the requirements of the 183- and- 60-days-test within a period of 12 months. The taxpayer has two easily identifiable qualifying periods:

- 2 May 2014 to 1 May 2015; and

- 20 December 2013 to 19 December 2014.

The following table sets out the work days outside South Africa for the period 2 May 2014 to 19 December 2014:

| Work days during period | Total work days during period | Actual work days outside South Africa | Actual work days in South Africa |
|---|---|---|---|
| 2 May 14 to 21 Jun 14 | 36 | 36 | |
| 22 Jun 14 to 6 Jul 14 | 10 | | 10 |
| 7 Jul 14 to 29 Aug 14 | 40 | 40 | |
| 30 Aug 14 to 7 Sep 14 | 5 | | 5 |
| 8 Sep 14 to 10 Nov 14 | 46 | 46 | |
| 11 Nov 14 to 20 Nov 14 | 8 | | 8 |
| 21 Nov 14 to 19 Dec 14 | 21 | 21 | |
| **Total** | **166** | **143** | **23** |

Z is not required to work over weekends, and weekends have thus been excluded from the total work days and actual work days calculations. Possible public holidays in New Zealand are not taken into account in this example.

The portion of Z's remuneration that is exempt from normal tax in South Africa under section 10(1)(*o*)(ii) is calculated as follows:

<u>Workdays outside South Africa for the period</u> x Remuneration received
Total workdays for the period during the period

= Exempt remuneration under section 10(1)(*o*)(ii)

= 143/166 x R500 000 = R430 722

Of the R500 000 remuneration earned by Z during the New Zealand assignment, R430 722 relates to services rendered in New Zealand during the 2015 year of assessment, and is exempt from normal tax in South Africa. It is irrelevant that Z was remunerated during this period by the New Zealand subsidiary. The remaining R69 278 earned during that period relates to services rendered in the Republic and is subject to normal tax in South Africa.

Remuneration earned in the Republic during the 2015 year of assessment before the assignment in New Zealand commenced (that is, for the period 1 March 2014 to 1 May 2014) and after the assignment terminated (for the period 20 December 2014 to 28 February 2015) is unaffected by the section 10(1)(*o*)(ii) exemption and is fully taxable in South Africa.

**Example 3 – Apportionment of income taking into account leave days**

*Facts:*

A South African resident employee, CE, is employed by a South African resident multinational employer engaged in activities in Africa. CE is required to spend considerable periods of time in various African countries fulfilling duties to the South African employer.

CE has met the 183- and-60-continuous-day test for the entire 2015 year of assessment. CE is not required to render services on weekends or public holidays. CE was outside the Republic for the purpose of rendering services for the following full days:

- 1 March 2014 to 25 April 2104 (Angola);
- 26 April 2104 to 15 May 2014 (Namibia);
- 1 July 2014 to 6 August 2014 (Mozambique);
- 23 September 2104 to 15 November 2014 (Nigeria);
- 4 January 2015 to 13 February 2015 (Angola).

CE took annual leave whilst in South Africa from 26 May 2014 up to and including 6 June 2014. CE also took a week annual leave whilst in Nigeria, from 20 up to and including 24 October 2014. CE's total remuneration from services rendered both within and outside South Africa for the 2015 year of assessment was R850 000.

*Result:*

The remuneration attributable to CE's services outside of South Africa qualifies for exemption. The portion that is exempt must be calculated using the apportionment formula. Leave days, like weekends, reduce the number of work days in the formula. South African public holidays have also been excluded from work days.

| Work days during period | Total work days during period | Actual work days outside South Africa | Actual work days in South Africa |
|---|---|---|---|
| 1 Mar 14 to 15 May 14***** | 48 | 48 | |
| 16 May 14 to 30 Jun 14 | 31 | | 21****** |
| 1 Jul 14 to 6 Aug 14 | 27 | 27 | |
| 7 Aug 14 to 22 Sep 14 | 33 | | 33 |
| 23 Sep 14 to 15 Nov 14 | 38 | 33[#] | |
| 16 Nov 14 to 3 Jan 15 | 31 | | 31 |
| 4 Jan 15 to 13 Feb 15 | 30 | 30 | |
| 14 Feb 15 to 28 Feb 15 | 10 | | 10 |
| **Total** | **248** | **138** | **95** |

* It is irrelevant whether the services outside South Africa are rendered in a single foreign jurisdiction or multiple jurisdictions. The requirement is simply that the employee be rendering services outside the Republic.

** The 10 working days annual leave taken by CE whilst in the Republic reduces the number of work days in the apportionment calculation.

[#] The 5 working days annual leave taken by CE whilst outside the Republic reduces the number of work days in the apportionment calculation.

The exempt portion of CE's remuneration is therefore calculated as follows:

$$\frac{\text{Workdays outside South Africa for the period}}{\text{Total workdays for the period}} \times \text{Remuneration received}$$

= Exempt remuneration under section 10(1)(*o*)(ii)

= 138 / 233## × R850 000 = R503 433

\## The total of 248 work days must be reduced by the 15 days annual leave that CE took during the year, as leave days must be excluded from the apportionment calculation. Similarly, the 5 days leave that CE took whilst outside South Africa must reduce the total of 148 work days that CE was outside of South Africa, to 138 work days.

R503 433 is exempt from taxation in South Africa. The remainder of CE's remuneration (that is, R346 567) remains subject to taxation in South Africa.

Certain employees are required, under the terms of their employment contracts as well as the health and safety regulations in force in various jurisdictions, to take specified rest days. Examples could include employees working shifts outside the Republic on oil rigs, who render services for a number of weeks and then must take an equivalent amount of time to rest. No actual services are rendered during the rest periods, even though the employees remain in continuous employment during these periods. The services that are rendered to earn the remuneration is the services that are rendered during the work shifts. If those services are rendered offshore, and during a qualifying period, all remuneration attributable to those offshore services will qualify for exemption and no apportionment must be done.

The cash equivalent of the value of a taxable benefit, calculated under the Seventh Schedule, also qualifies for exemption and thus apportionment, unless the benefit is granted for exclusive use in South Africa.

### 4.3 Gains under section 8C and section 10(1)(*o*)(ii)

Employees may participate, by virtue of their employment, in various share incentive schemes offered by their employers. Gains made under such share schemes are subject to taxation in South Africa, but could qualify for exemption under section 10(1)(*o*)(ii) under certain circumstances, discussed more fully below.

The inclusion of a gain in income under section 8C takes place when the "vesting" of the equity instrument occurs.[30] However, vesting is not the originating cause of the gain being received as income. The services rendered by the employee is the originating cause. Thus, for purposes of section 10(1)(*o*)(ii), to correctly apportion the gain between South African and foreign services, the place where the services were rendered must be looked to, and not the place where the right to participate was offered or accepted, or the place where the employee was located when vesting took place.

Ordinarily, share schemes serve two purposes:

- They reward employees who have performed well; and

[30] For a discussion on the operation of section 8C, see Interpretation Note No. 55 (Issue 2) dated 30 March 2011 "Taxation of Directors and Employees on Vesting of Equity Instruments".

- They provide a mechanism to retain an employee in employment for a specified period.

Share schemes therefore generally have two periods relevant to the inclusion of the gain as income: the “reward” period and the “lock-in” period. The “reward” period is where employers grant rights to employees to participate in share schemes as a reward for past performance, for example, participation due to exceptional performance during the previous financial year of the employer. The “lock-in” period is a forward-looking period, where employees are prohibited from benefiting under the scheme until pre-determined fixed future dates, with the employees generally required to be in employment at the end of the lock-in period in order to participate in the benefits. The terms of the employment agreement and the rules and participation terms of the share scheme will determine what these periods are.

The location of services rendered during both the “reward” period and the “lock-in” period must be taken into account when determining the period of apportionment of the gain under section 10(1)(*o*)(ii).

The gain is deemed to have accrued evenly, and must therefore be apportioned evenly, over the period that the services were rendered[31] (see **4.2**).

The sourcing period for section 8C gains will, depending on the circumstances, be as follows:

- From the first day of the “reward” period that gave rise to the granting of a right to participate in a share scheme, up to the date of vesting of the equity instrument under section 8C; or
- From the date of grant to the date of vesting of the equity instrument, where there is simply a “lock-in” period and no “reward” period.

Once the sourcing period of the gain is determined and the employee has qualified for the section 10(1)(*o*)(ii) exemption, the exempt portion must be calculated based on the following apportionment method:

$$\frac{\text{Work days outside South Africa in the sourcing period}}{\text{Total work days in the sourcing period}} \times \text{Section 8C gain}$$

= Exempt portion of the gain under section 10(1)(*o*)(ii).

*Note*: Weekends, public holidays and leave days are excluded from work days for purposes of this calculation (see **4.2**).

The “sourcing period” in this formula refers to the “reward” period and the “lock-in” period that the share gains relate to, as discussed above.

**Example 4 – Apportionment of gains made under section 8C**

*Facts:*

On 1 July 2009, DG, an employee of a South African holding company, acquired 5 000 shares (at R5 each) from the South African company by virtue of employment. Under the agreement, DG was not permitted to dispose of the shares until 1 July 2014. The shares were granted solely to retain DG’s services.

31 Proviso (C) to section 10(1)(*o*)(ii).

DG rendered services to a Nigerian subsidiary company, during the period 1 February 2011 to 31 January 2013. DG met the 183- and-60-days-continuous test for this entire period, and thus any remuneration earned for services rendered outside of South Africa during that period qualifies for exemption under section 10(1)(*o*)(ii).

DG was in Nigeria and rendered services for a total of 460 actual work days during that qualifying period.

DG also rendered services outside the Republic, during the lock-in period but outside any qualifying period, as follows:

- 1 October 2009 to 30 October 2009; and
- 10 April 2014 to 26 May 2014.

On 1 July 2014, when DG became entitled to dispose of the shares, they vested under section 8C, and had a market value of R43 per share. DG therefore made a gain of R190 000 [5 000 × (R43 – R5)].

To simplify illustration in this example, any leave days taken are ignored.

*Result:*

The portion of the gain made by DG on the vesting of the equity instruments that relates to services rendered outside of South Africa during the qualifying period of 12 months is exempt from taxation under section 10(1)(*o*)(ii). The exempt portion must be calculated as follows:

$$\frac{\text{Workdays outside South Africa for the sourcing period}}{\text{Total workdays for the sourcing period}} \times \text{Section 8C gain}$$

= Exempt remuneration under section 10(1)(*o*)(ii)

= 460 / 1 250 × R190 000 = R69 920

The balance of the section 8C gain of R120 080 remains taxable in South Africa.

There are a total of 1 250 work days during the sourcing period, being from 1 July 2009 to 1 July 2014. The gain is deemed to be spread evenly over this period.[32]

The gains attributable to periods where services were rendered outside the Republic, but that do not fall within a qualifying 12-month period, being the periods of 1 to 30 October 2009 and 10 April to 26 May 2014, do not qualify as days outside South Africa under the formula, and the gains attributable to services rendered during those periods remains fully taxable in South Africa.

## 5. General provisions

The potential for an exemption under section 10(1)(*o*)(ii) does not automatically waive the obligation of an employer to deduct employees' tax under the Fourth Schedule. An employer that is satisfied that the provisions of section 10(1)(*o*)(ii) will

[32] Proviso (C) to section 10(1)(*o*)(ii).

apply in a particular case may, however, elect not to deduct employees' tax in a particular case. In the case where the exemption was not applicable, the employer will be liable for the employees' tax not deducted as well as the concomitant penalties and interest.

For employees' tax certificate (IRP5 certificate) purposes, each remuneration item qualifying for the section 10(1)(*o*)(ii) exemption must be disclosed under the relevant foreign service income source code. For example, foreign salary income must be disclosed under code 3651, bonus payments under code 3655 and medical aid contributions under code 3860.[33] *Code 3652 may not be used for any remuneration item that may qualify for exemption under section 10(1)(*o*)(ii)*.

An employer that has deducted or withheld employees' tax where it subsequently transpires that the remuneration qualifies for exemption under section 10(1)(*o*)(ii) **may not refund over-deducted employees' tax to an employee**.[34] The employee must claim a refund on assessment. Supporting documentation in the form of, for example, a passport and an employment contract, may be requested from the employee to substantiate the exemption claimed on assessment.

Remuneration that is exempt under section 10(1)(*o*)(ii) is not "remuneration" as defined in paragraph 1 of the Fourth Schedule.[35] As such amounts are not "remuneration", they are not subject to unemployment insurance fund contributions under the Unemployment Insurance Contributions Act No. 4 of 2002 or the skills development levy under the Skills Development Levies Act No. 9 of 1999 unless the Minister of Higher Education and Training, by notice in the *Gazette*, determines a different basis for the calculation of the levy, which basis included such exempt amounts.[36] Any remuneration that remains taxable in South Africa will still be subject to the deduction or withholding of levies or contributions under these statutes.

**Legal and Policy Division**
**SOUTH AFRICAN REVENUE SERVICE**

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[33] For details on the correct IRP5 disclosure, see the *Guide for Codes applicable to Employees' Tax Certificates 2015* available on the SARS website **www.sars.gov.za**.
[34] Paragraph 29 of the Fourth Schedule.
[35] The term "remuneration" is defined to mean "*…any amount of **income**…*" [emphasis added]. "Income" as defined in section 1(1) excludes exempt income.
[36] Section 3(6) of the Skills Development Levies Act.

**Annexure – Diagram**

**Basic steps to be followed in determining the exemption**