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SARS
South African Revenue Service

DRAFT INTERPRETATION NOTE

DATE:

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 10(1)(*gC*)(ii)
SUBJECT : EXEMPTION – FOREIGN PENSIONS AND TRANSFERS

Preamble

In this Note unless the context indicates otherwise –

- **"foreign services"** means services rendered outside the Republic;
- **"local retirement fund"** means a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in section 1(1);
- **"Republic"** means "Republic" as defined in section 1(1);
- **"resident"** means "resident" as defined in section 1(1);
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides clarity on the interpretation and application of section 10(1)(*g*C)(ii) in respect of a lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic, and in respect of amounts transferred from a source outside the Republic into a local retirement fund.

2. Background

Section 10(1)(*g*C)(ii) exempts from normal tax any lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic as consideration for past employment outside the Republic.

With effect from 1 March 2017, this exemption does not apply to a lump sum, pension or an annuity paid from any local retirement fund, except to the extent that an amount is transferred to that local retirement fund from a source outside the Republic in respect of that member.

3. The law

Section 10(1)(*g*C)

> **10. Exemptions.**—(1) There shall be exempt from normal tax—
>
> (*g*C) any—
>
> (i) amount received by or accrued to any resident under the social security system of any other country; or
>
> (ii) lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic as consideration for past employment outside the Republic other than from any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in section 1(1) excluding any amount transferred to that fund from a source outside the Republic in respect of that member;

4. Application of the law

The term "past employment outside the Republic" refers to foreign services. Only the portion of the lump sum, pension or annuity that relates to foreign services is exempt from income tax. Amounts that are not related to foreign services will therefore not qualify for the exemption.

Two references are made to the term "source outside the Republic" in section 10(1)(*g*C)(ii).

4.1 Amounts paid from foreign funds

The word "source" has a longstanding meaning under South African domestic law. In *CIR v Lever Bros & Unilever Ltd*,[1] the majority judgement stated –

> "…the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them."

The originating cause of a lump sum, pension or annuity received by or accrued to any resident *as consideration for past employment* will be the location where those services were rendered. If services were rendered in the Republic, the source of the lump sum, pension or annuity will be the Republic. If the originating cause of a receipt is situated in more than one country, the source thereof would be in each respective country.[2] This means that an apportionment is required, based on where the services were rendered.[3]

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[1] 1946 AD 441, 14 SATC 1.

[2] *CIR v Lever Bros & Unilever Ltd* 1946 AD 441, 14 SATC 1; *COT (SR) v Shein* 1958 (3) SA 14 (FC), 22 SATC 12.

[3] This is further confirmed by application of the source principles in section 9(2)(*i*).

The first reference to the term "source outside the Republic" in section 10(1)(*g*C)(ii), is as follows:

> "**10. Exemptions.**—(1) There shall be exempt from normal tax—
>
> (*g*C) any—
>
> (ii) lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic as consideration for past employment outside the Republic…"

(Emphasis added.)

The term "source outside the Republic", for purposes of the first reference thereto in section 10(1)(*g*C)(ii), refers to the originating cause which gives rise to the lump sum, pension or annuity. This is where the services have been rendered.

The following formula is used to calculate the portion of a lump sum, pension or annuity that will be exempt as a result of services rendered outside the Republic:

$$\frac{\text{Foreign services rendered}}{\text{Total services rendered}} \times \text{Total amount received or accrued}$$

Example 1 – Exemption for foreign pension

Facts:

X is a resident of the Republic and worked for a foreign employer from 1990 to 2017. During this period, X was a member of the employer's foreign retirement fund. X retired in the 2017 year of assessment after 27 years service, and qualified for a lump sum of R1,2 million. X rendered services on behalf of the foreign employer, for 9 years in the Republic and for 18 years in the foreign country. Although X retired in the Republic, X remained a member of the foreign retirement fund.

Result:

X, a resident of the Republic, received a lump sum from a source outside the Republic as consideration for past employment outside the Republic. X therefore qualifies for an exemption from income tax, which is calculated as follows:

$$\frac{\text{Foreign services rendered}}{\text{Total services rendered}} \times \text{Total amount received or accrued}$$

$$= \frac{\text{18 years}}{\text{27 years}} \times \text{R1,2 million}$$

= R800 000

Of the lump sum of R1,2 million, R800 000 qualifies for exemption from income tax in the Republic. The remaining R400 000 (the portion relating to services rendered in the Republic) will be subject to tax in the Republic. As the lump sum was not paid from a local retirement fund, the amount will not qualify for the special rates of tax applicable to retirement fund lump sum benefits. The amount will be included in X's "gross income" as defined in section 1(1) and will be subject to tax by application of the rates of normal tax applicable to individuals. For purposes of simplification, the applicable provisions of a double tax treaty have not been considered in this example.

4.2 Amounts paid from local retirement funds

The second reference to "source outside the Republic" in section 10(1)(*g*C)(ii), is as follows:

> "**10. Exemptions.**—(1) There shall be exempt from normal tax—
>
> (*g*C) any—
>
> (ii) lump sum, pension or annuity…other than from any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as defined in section 1 (1) excluding any amount transferred to that fund from a source outside the Republic…"

(Emphasis added.)

A lump sum, pension or annuity paid by a local retirement fund to a resident will not qualify for exemption except in cases where an amount has been transferred to that local retirement fund from a source outside the Republic. Reference is made to an amount transferred to a local retirement fund from a source outside the Republic. It would mean that a *specified amount* must be transferred to a local retirement fund from a source outside the Republic in order for the exemption to apply.

In the second reference to the term "source outside the Republic", it cannot be maintained that the word "source" must be read in relation to the originating cause, since the originating cause in respect of a lump sum, pension or annuity would be the services that were rendered. (See **4.1**) It is not the services that were rendered that are transferred to the local retirement fund, but rather a specified amount. In this context, "source outside the Republic" means that an amount must have been transferred from outside the Republic to a local retirement fund.

Only the portion of the amount transferred that relates to foreign services will, however, qualify for exemption.

The exempt portion should be calculated as follows:

Step 1

Determine the portion of the amount received or accrued that relates to the amount transferred to the local retirement fund. This can be simplified by way of the following formula:

$$\frac{\text{The amount transferred}}{\text{Total retirement interest}} \times \text{Amount received or accrued}$$

Step 2

Determine the portion of the amount transferred (calculated in step 1) that relates to foreign services rendered, bearing in mind that only the foreign service element will qualify for exemption. This step will only be necessary if there are both foreign services and services in the Republic. The following formula can be applied:

$$\frac{\text{Foreign services rendered}}{\text{Total services rendered}} \times \text{Amount calculated in Step 1}$$

Note that the foreign services rendered and total services rendered in the above formula will be as at the date the amount was transferred into the local retirement

fund. The formulae can be applied to calculate the exempt portion of either a lump sum, pension or an annuity.

Example 2 – Exemption for amounts paid by a local retirement fund with a foreign fund transfer

Facts:

Z, a resident of the Republic, is employed by a multinational company from 1992 to 2017. Z contributed to the employer's foreign fund from 1992 to 2012. In 2012, Z decided to remain in the Republic and chose to transfer the full value of R15 million in the foreign fund (at that stage) into the employer's local retirement fund. During the period of 20 years during which Z was a member of the foreign fund, Z rendered 15 years' service outside the Republic and 5 years service in the Republic. Z retired in 2017. The fund value on retirement date is R27 million. Z takes R9 million as a lump sum and the remaining R18 million in the form of a monthly pension from the employer's local retirement fund.

Result:

Step 1

The portion of the lump sum payable to Z which relates to the amount transferred from the foreign fund to the local retirement fund will be calculated as follows:

$$\frac{\text{The amount transferred}}{\text{Total retirement interest}} \times \text{Amount received or accrued}$$

$$= \frac{\text{R15 million}}{\text{R27 million}} \times \text{R9 million}$$

= R5 million

This means that R5 million of the lump sum is attributable to the amount transferred from the foreign fund to the local retirement fund.

Step 2

Only the portion of the amount transferred that relates to foreign services will qualify for exemption, and the following formula can be applied:

$$\frac{\text{Foreign services rendered}}{\text{Total services rendered}} \times \text{Amount calculated in Step 1}$$

$$= \frac{\text{15 years}}{\text{20 years}} \times \text{R5 million}$$

= R3 750 000

The balance of R1 250 000 (R5 million less R3 750 000 exemption) will be subject to tax as per the special rates of tax applicable to retirement fund lump sum benefits. Note that the same formulae can be applied to determine the exempt portion in respect of the monthly pension. For purposes of simplification, the applicable provisions of a double tax treaty have not been considered in this example.

5. Conclusion

Section 10(1)(*g*C)(ii) exempts from normal tax any lump sum, pension or annuity received by or accrued to any resident from a source outside the Republic as consideration for foreign services rendered. With effect from 1 March 2017, however, this exemption will no longer apply to a lump sum, pension or an annuity paid from any local retirement fund, except to the extent that an amount that relates to foreign services rendered was transferred to that local retirement fund.

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