DRAFT

SARS
South African Revenue Service

DRAFT INTERPRETATION NOTE 16 (Issue 3)

DATE:

ACT	**:**	**INCOME TAX ACT 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 –

- **"SDL"** refers to the skills development levy under the Skills Development Levies Act, 1999;
- **"section"** means a section of the Act;
- **"the Act"** means the Income Tax Act 58 of 1962;
- **"UIF"** refers to unemployment insurance fund contributions under the Unemployment Insurance Contributions Act, 2002; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issues of these documents should be consulted.

1. Purpose

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

2. Background

The exemption under section 10(1)(*o*)(ii) was introduced in 2000 to prevent double taxation of an individual's income between South Africa and a host country. The exemption creates opportunities for double non-taxation in instances where the host country imposes little or no tax on employment income. This outcome is contrary to the purpose for which the exemption was introduced. It was originally indicated that the impact of the exemption would be monitored with specific focus on whether the exemption is unduly exploited resulting in no foreign tax on foreign employment income.

From 1 March 2020 and in respect of years of assessment commencing on or after that date, foreign employment income earned by a tax resident of South Africa will no longer be fully exempt as the exemption under section 10(1)(*o*)(ii) will be limited to R1 million. Any foreign employment income earned over and above R1 million will be subject to normal tax in South Africa, applying the normal tax rates for the particular year of assessment. All requirements to qualify for the exemption under section 10(1)(*o*)(ii) remain the same.

The Note discusses the requirements to qualify for the exemption under section 10(1)(*o*)(ii). The impact of the limitation of the exemption and 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.

3. The law

The relevant sections of the Act are quoted in **Annexure A**. A table displaying the comparisons between section 10(1)(*o*)(i),[1] 10(1)(*o*)(iA)[2] and 10(1)(*o*)(ii) insofar as the application of an exemption from foreign employment services, is set out in **Annexure C**.

4. Application of the law

4.1 Qualification criteria for the exemption

In order to qualify for the exemption, a taxpayer must be a tax resident of South Africa who earns certain types of remuneration for employment services rendered outside the Republic. The exemption will only be available provided the specified qualifying periods are met and none of the exclusions apply.

These requirements are analysed and interpreted below.

4.1.1 Remuneration

Not all remuneration[3] 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,[4] as too are amounts referred to in sections 8,[5] 8B[6] or 8C.[7]

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 *subsequent* to a qualifying period, but *in respect* of such qualifying period, will qualify for the exemption, but subject to any applicable apportionment (see **4.3**).

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1 See Interpretation Note 34 (Issue 2) "Exemption from Income Tax: Remuneration Derived by a Person as an Officer or Crew Member of a Ship" for a discussion on the operation of section 10(1)(*o*)(i).

2 See Interpretation Note 34 for a discussion on the operation of section 10(1)(*o*)(iA).

3 The term remuneration is not "remuneration" as defined in the Fourth Schedule.

4 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.

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

6 Taxation of amounts derived from broad-based employee share plans.

7 Taxation of directors and employees on vesting . See **4.3**.

Remuneration received by or accrued during a qualifying period for services rendered ***within*** the Republic does not qualify for exemption. Remuneration earned during a qualifying period in respect of services that were rendered both inside and outside the Republic must be apportioned (see **4.3**) 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"[8] 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.[9] Directors in their capacity as directors are holders of an office, not employees, and to the extent that they earn director's 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 employment[10] 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 "Republic" is defined in section 1(1). The definition encompasses the landmass of South Africa as well as its territorial waters,[11] which is a belt of sea adjacent to the landmass but not exceeding 12 nautical miles (roughly 22,2 km) beyond the baselines[12] of the country.

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

[9] See Interpretation Note 17 (Issue 5) "Employees' Tax: Independent Contractors" for a discussion on employees and independent contractors under the common law.

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

[11] Defined in section 4 of the Maritime Zones Act 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.

[12] Defined in section 2 of the MZA and Article 3 of UNCLOS.

In certain circumstances, the Republic may extend beyond the geographical limits of its landmass and territorial waters. The definition of the "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[13] and international law,[14] which provide for South Africa's right to explore and exploit natural resources in the exclusive economic zone[15] and on the continental shelf.[16]

The exclusive economic zone extends to 200 nautical miles (roughly 370,6 km) from the baselines.[17] The continental shelf extends to the outer edge of the continental margin, or 200 nautical miles from the baselines, whichever is the greater.[18]

These are factors that must be considered when determining whether a person renders services in the Republic or outside 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.

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> the Republic are taken into account for purposes of calculating the period or periods outside the Republic.

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[13] Section 7 of the MZA.

[14] Section 233 of the Constitution of the Republic 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.

[15] 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…*"

[16] 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.

[17] Section 7 of the MZA and Article 57 of UNCLOS.

[18] Section 8 of the MZA and Article 76(1) of UNCLOS.

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 **4.3**).

A distinction must be made between a situation where a person is in employment and is actually outside the Republic but is not physically rendering services, and a situation where a person is physically present outside the Republic but is not in employment. Section 10(1)(*o*)(ii) clearly links the days test to the person's employment. Days spent outside the Republic when a person is not in employment do not qualify as days outside the Republic 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 the Republic, but only render services for specified periods and then have rest periods, will be able to claim the rest period days as days outside the Republic 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 the Republic 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 the Republic 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 the Republic, that same period of 12 months must be used to determine whether the person spent a continuous period exceeding 60 full days outside the Republic.

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 the Republic 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.[19] This documentation may include, without limiting the scope of what could be requested by SARS, letters of secondment, employment contracts for foreign services, travel schedules and copies of passports. This documentary proof will assist in the verification of the period or periods worked outside the Republic.

[19] Section 46(4) of the Tax Administration Act 28 of 2011.

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.[20] Section 2 of the Interpretation Act[21] 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.[22]

In *Subbulutchmi v Minister of Police and Another*,[23] James JP stated the following:[24]

> "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.

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-day and 60-continuous-day tests 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

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

[21] Act 33 of 1957.

[22] *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.

[23] 1980 (3) SA 396 (D); subsequently approved by the Appellate Division in *Minister of Police v Subbulutchmi* 1980 (4) SA 768 (A).

[24] At page 397 F-G.

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 meet the requirement of the 183-full-days 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 12th of a month and end on the 11th of that month in the following year. The test could therefore also be applied on a daily basis, which means that a person can consider a 365- or 366-day period looking both forwards and backwards from any specific day.

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 2019 to 30 September 2019 (seven months). An employment contract was entered into stipulating X would be remunerated by the South African holding company. X did not return to the Republic during this period.

Result:

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

Persons in transit through the Republic[25]

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

- the person does not formally enter the Republic through a port of entry as contemplated in section 9(1) of the Immigration Act 13 of 2002; or
- the person does not formally enter the Republic 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**).

[25] Proviso (A) to section 10(1)(*o*)(ii).

4.1.6 Exceptions[26]

The following two categories of employees are expressly excluded from the exemption:

- A public office holder, as contemplated in section 9(2)(*g*), who must be appointed or deemed to be appointed under an Act of Parliament.[27]
- Employees of employers, as contemplated under section 9(2)(*h*), 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,[28] and municipal entities.[29]

4.2 Limitation of the exemption

From 1 March 2020, foreign employment income is no longer fully exempt under section 10(1)(*o*)(ii). The exemption is limited to R1 million in respect of each year of assessment during which the requirements of section 10(1)(*o*)(ii) are met. The qualifying criteria (as set out in **4.1.1** to **4.1.5**) for the exemption remain the same.

Any foreign employment income earned over and above R1 million will be taxed in the Republic, applying the normal tax rates for that particular year of assessment.

A double tax situation may arise in respect of the portion of the remuneration earned over and above the R1 million. This will happen where a tax treaty does not provide a sole taxing right to one country; which means both countries will have a right to tax the income and the country of residence, in our case the Republic, will provide double tax relief. Section 6*quat* is the mechanism under South Africa's domestic law to claim relief from double tax where the amount received for services rendered outside the Republic is subject to tax in the Republic and in the foreign country. This credit may be claimed on assessment when an individual submits an income tax return, provided certain requirements are met. This effectively means that the foreign tax paid on the portion of remuneration included in income will be set-off against the South African normal tax paid so that no double tax is ultimately suffered.[30]

An employer may at his or her discretion, under paragraph 10 of the Fourth Schedule, apply for a directive from SARS to vary the basis on which employees' tax is withheld monthly in the Republic. The potential foreign tax credit is taken into account to determine the employees' tax that has to be withheld for payroll purposes. This is not the actual granting of the section 6*quat* credit. The employee is still required to submit an income tax return in which the actual foreign tax credit under section 6*quat* should be claimed.

4.3 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*

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26 Proviso (B) to section 10(1)(*o*)(ii).
27 Under section 9(2)(*g*).
28 Act 1 of 1999.
29 As defined in section 1 of the Local Government: Municipal Systems Act 32 of 2000.
30 See Interpretation Note 18 (Issue 4) "Rebates and Deduction for Foreign Taxes on Income" for a detailed discussion on section 6*quat*.

qualifying period of 12 months is exempt. Remuneration received or accrued during a qualifying period of 12 months **in respect of services rendered within the Republic remains subject to tax in South Africa**. Once a person has met the 183-day and 60-continuous-day 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. The exemption will be limited to R1 million.

It is accepted that it is correct to apportion income if it is clear that a portion of such income relates to services rendered both inside and outside the Republic. However, if the services rendered inside the Republic by a person are merely casual and accidental,[31] or subsidiary and incidental,[32] then the originating cause of the employment income will be fully outside the Republic and no apportionment will be necessary.

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.[33] 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 **4.4** and **Example 5**).

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

Work days outside the Republic for the period / *Total work days for the period*	×	*Remuneration received during the period*

= Exempt portion of remuneration limited to R1 million

"Work days" does 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 the Republic. To the extent that incidental work days inside the Republic are regarded as being from a source outside the Republic, those days must be considered to be work days outside the Republic.

Remuneration received for services rendered during work days in the Republic 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 will be leaving the Republic on 1 May 2020 to commence work on 2 May 2020. Z was contracted to work in New Zealand until 19 December 2020. The subsidiary company in New Zealand will be remunerating Z during this period. Z will be departing New Zealand on 20 December 2020 to return to the Republic.

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[31] ITC 77 3 SATC 72.

[32] *COT (SR) v Shein* 1958 (3) SA 14 (FC), 22 SATC 12.

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

For purposes of the example, it is assumed that Z will be returning to the Republic to fulfil local employment obligations during the following periods, which will include travel days:

- 22 June 2020 to 6 July 2020;
- 30 August 2020 to 7 September 2020; and
- 11 November 2020 to 20 November 2020.

Result:

The number of calendar days for which remuneration will be derived for services rendered in New Zealand in the 2021 year of assessment will be as follows:

	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
2 May 20 to 21 June 20	30	21							51
7 July 20 to 29 Aug 20			25	29					54
8 Sept 20 to 10 Nov 20					23	31	10		**64**
21 Nov 20 to 19 Dec 20							10	19	29
									198

The total remuneration that Z will be receiving for services rendered during the period 2 May 2020 to 19 December 2020 will be R1 500 000.

As the table above indicates, the taxpayer will satisfy the requirements of the 183-day and 60-continuous-day tests within a period of 12 months. The taxpayer will have two easily identifiable qualifying periods:

- 2 May 2020 to 1 May 2021; and
- 20 December 2019 to 19 December 2020.

The following table sets out the work days outside the Republic for the period 2 May 2020 to 19 December 2020:

Work days during period	**Total work days during period**	**Actual work days outside the Republic**	**Actual work days in the Republic**
2 May 20 to 21 Jun 20	34	34	
22 Jun 20 to 6 Jul 20	11		11
7 Jul 20 to 29 Aug 20	38	38	
30 Aug 20 to 7 Sep 20	6		6
8 Sep 20 to 10 Nov 20	45	45	
11 Nov 20 to 20 Nov 20	8		8
21 Nov 20 to 19 Dec 20	19	19	
Total	**161**	**136**	**25**

Z will not be 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 have not been taken into account in this example.

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

$$\frac{\text{Work days outside the Republic for the period}}{\text{Total work days for the period}} \times \text{Remuneration received during the period}$$

= Remuneration that may qualify for the exemption under section 10(1)(*o*)(ii)

= 136/161 × R1 500 000 = R1 267 081, however the exemption is limited to **R1 000 000**.

Thus, R500 000 will be subject to normal tax in South Africa.

Of the R1 500 000 remuneration Z will be earning during the New Zealand assignment, R1 267 081 relates to services rendered in New Zealand during the 2021 year of assessment, and of that amount R1 000 000 will be exempt from normal tax in South Africa. Z will be remunerated during this period by the New Zealand subsidiary. R500 000 over and above the R1 000 000, which is made of the following two parts, will be subject to normal tax in South Africa:

- R267 081 that relates to services rendered outside South Africa will be subject to tax in South Africa, and may qualify for relief under section 6*quat*(1), provided foreign taxes are proved to be payable on that amount and the requirements under that section are met.
- R232 919 that will be earned during that period will relate to services rendered in the Republic and will also be subject to normal tax in South Africa. No relief in the form of a tax credit will be applicable against this portion of the income.

Remuneration earned in the Republic during the 2021 year of assessment before the assignment in New Zealand commences (that is, for the period 1 March 2020 to 1 May 2020) and after the assignment terminates (for the period 20 December 2020 to 28 February 2021) will be unaffected by the section 10(1)(*o*)(ii) exemption and will be 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.

For purposes of this example it is assumed that CE will meet the 183-day and 60-continuous-day test for the entire 2021 year of assessment. CE will not be required to render services on weekends or public holidays. CE will be outside the Republic for the purpose of rendering services for the following full days:

- 1 March 2020 to 25 April 2020 (Angola);
- 26 April 2020 to 15 May 2020 (Namibia);
- 1 July 2020 to 6 August 2020 (Mozambique);

- 23 September 2020 to 15 November 2020 (Nigeria);
- 4 January 2021 to 13 February 2021 (Angola).

It is further assumed that CE will take annual leave whilst in the Republic from 26 May 2020 up to and including 6 June 2020. CE will also take a week's annual leave whilst in Nigeria, from 20 up to and including 24 October 2020. CE's total remuneration from services rendered both within and outside the Republic for the 2021 year of assessment will be R1 450 000.

Result:

The remuneration attributable to CE's services outside the Republic will qualify for exemption. The portion that will be exempt must be calculated using the apportionment formula. Leave days and weekends reduce the number of work days in the formula. South African public holidays are also excluded from work days.

Work days during period	Total work days during period	Actual work days outside the Republic	Actual work days in the Republic
1 Mar 20 to 15 May 20*	51	51	
16 May 20 to 30 Jun 20	31		21**
1 Jul 20 to 6 Aug 20	27	27	
7 Aug 20 to 22 Sep 20	32		32
23 Sep 20 to 15 Nov 20	37	32#	
16 Nov 20 to 3 Jan 21	32		32
4 Jan 21 to 13 Feb 21	30	30	
14 Feb 21 to 28 Feb 21	10		10
Total	**250**	**140**	**95**

* It is irrelevant whether the services outside the Republic 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:

$$\frac{\text{Work days outside the Republic for the period}}{\text{Total work days for the period}} \times \text{Remuneration received}$$

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

= 135/235## × R1 450 000 = R832 979

The total of 250 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 the Republic must reduce the total of 140 work days that CE was outside the Republic, to 135 work days.

R832 979 is less than R1 000 000 and will therefore be fully exempt from taxation in South Africa. The remainder of CE's remuneration (that is, R617 021) will remain 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.[34]

The cash equivalent of the value of a taxable benefit, calculated under the Seventh Schedule, also qualifies for exemption and thus apportionment.

4.4 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.[35] However, vesting is not the originating cause of the gain being received as income. The services rendered by the employee are the originating cause. Thus, for purposes of section 10(1)(*o*)(ii), to correctly apportion the gain between services rendered in the Republic 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
- 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

[34] If rest periods are taken in the Republic, it will have an impact of the 183-day and 60-continuous-day test but it will not impact the apportionment calculation.

[35] For a discussion on the operation of section 8C, see Interpretation Note 55 (Issue 2) "Taxation of Directors and Employees on Vesting of Equity Instruments".

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.

Example 4 – Meaning of the "reward" and "lock-in" period

Facts:

On 1 May 2016, X, an employee of a South African holding company, acquired shares from the South African company by virtue of employment. Under the agreement, X was not permitted to dispose of the shares until 1 May 2020. The shares were granted both for exceptional performance by X during the company's previous financial year (1 May 2015 to 30 April 2016) and as an incentive to retain X's services during the lock-in period.

Result:

The following periods are relevant to determine the sourcing period of the gain:

- The reward period: 1 May 2015 to 30 April 2016 (the period during which services were rendered in respect of the reward).
- The lock-in period: 1 May 2016 to 30 April 2020 (the period during which the shares have not yet vested and for which the employee is required to render services until the restriction is lifted).

The sourcing period runs therefore from 1 May 2015 to 30 April 2020, since under the agreement the shares were granted to X for both as a reward for exceptional performance during the company's previous financial year and as an incentive to retain X's services during the lock-in period.

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[36] (see **4.3**).

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.

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

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:

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

= Exempt portion of the gain under section 10(1)(*o*)(ii), limited to R1 million.

Weekends, public holidays and leave days are excluded from work days for purposes of this calculation (see **4.3**).

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 5 – Apportionment of gains made under section 8C

Facts:

On 1 July 2015, DG, an employee of a South African holding company, acquired 45 000 shares (at R5 each) from the South African company by virtue of employment. Under the agreement, DG is not permitted to dispose of the shares until 1 July 2020. The shares were granted solely to retain DG's services.

DG rendered services to a Nigerian subsidiary company, during the period 1 February 2017 to 31 January 2019. DG met the 183-day and 60-continuous-day tests for this entire period, and thus any remuneration earned for services rendered outside the Republic during that period qualifies for exemption under section 10(1)(*o*)(ii).

DG was in Nigeria and rendered services for a total of 540 actual work days during that qualifying period.

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

- 1 October 2015 to 30 October 2015; and
- 10 April 2020 to 26 May 2020.

On 1 July 2020, when DG will become entitled to dispose of the shares, they will vest under section 8C, and, it is assumed that they will have a market value of R85 per share. DG will therefore make a gain of R3 600 000 [R45 000 × (R85 – R5)].

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

Result:

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

Work days outside the Republic for the sourcing period × Section 8C gain
Total work days for the sourcing period

= The portion of the Section 8C gain that may qualify for exemption under section 10(1)(*o*)(ii), limited to R1 000 000.

= 540/1 252 × R3 600 000 = R1 552 716, however the exemption is limited to **R1 000 000**.

Thus, the R552 716 that exceeds the R1 million exemption will be subject to normal tax in South Africa.

The amount with which the R1 million exemption is exceeded, that is, R552 716 (that relates to the work days outside the Republic) and the amount that relates to the days that DG worked in the Republic R2 047 284 (R3 600 000 – R1 552 716) will be subject to normal tax in South Africa.

There are a total of 1 252 work days during the sourcing period, being from 1 July 2015 to 1 July 2020. The gain is deemed to be spread evenly over this period.[37]

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 2015 and 10 April 2020 to 26 May 2020, do not qualify as days outside the Republic under the formula, and the gains attributable to services rendered during those periods remain fully taxable in South Africa.

5. Employees' tax, UIF and SDL

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 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.[38]

For employees' tax certificate (IRP5 certificate) purposes, each remuneration item in respect of foreign service income must be disclosed under the relevant foreign income source code. For example, foreign sourced salary income must be disclosed under code 3651, bonus payments under code 3655 and medical aid contributions under code 3860.

Code 3652 may not be used for any remuneration item that may qualify for exemption under section 10(1)(*o*)(ii) as there are specific foreign income source codes for each item that should be used. If an employer discloses any foreign

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

[38] A foreign employer may have an obligation to withhold employees' tax in South Africa if such employer has a representative employer in South Africa.

sourced income under code 3652, the exemption under section 10(1)(*o*)(ii) will not be applied on assessment.

An employer that is satisfied that the exemption under section 10(1)(*o*)(ii) applies, should disclose the salary income in the following way: To the extent that the remuneration is exempt, it must be disclosed under the foreign income source code indicating the amount from which no employees' tax was withheld, and if the remuneration exceeds R1 million and becomes subject to normal tax, the excess remuneration should be disclosed as a separate line item under the same foreign source code indicating the amount from which PAYE was withheld.

For example:

- **Code 3601** – Salary earned in South Africa (if applicable), subject to normal tax.
- **Code 3651** – Salary earned outside of South Africa that is less than R1 million and exempt under section 10(1)(*o*)(ii) with no PAYE.
- **Code 3651** – Salary earned outside of South Africa that exceeds R1 million, with PAYE.

The above principle will apply in the same way to all relevant remuneration items.[39]

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**.[40] The employee must claim a refund on assessment. Supporting documentation in the form of, for example, a travel schedule, a passport and an employment contract, may be requested from the employee to substantiate the exemption claimed on assessment.

Any amount that is exempt under section 10(1)(*o*)(ii) no longer constitutes "remuneration" as defined in paragraph 1 of the Fourth Schedule.[41] These amounts are not subject to the deduction of UIF or SDL unless, in respect of SDL, 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.[42] Any remuneration that remains taxable in South Africa will still be subject to the deduction or withholding of levies or contributions under these statutes.

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SOUTH AFRICAN REVENUE SERVICE
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39 For details on the correct IRP5 disclosure, see *Guide for Codes applicable to Employees' Tax Certificates 2019*.
40 Paragraph 29 of the Fourth Schedule.
41 "Remuneration" is defined to mean "*…any amount of **income**…*" (Emphasis added). "Income" as defined in section 1(1) excludes exempt income.
42 Section 3(6) of the SDL Act.

Annexure A – The law

Definition of "Republic" in section 1(1)

"Republic" means the 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;

Section 10(1)(*o*)

(o) any form of remuneration—

(ii) to the extent to which that remuneration does not exceed one million Rand in respect of a year of assessment and is received by or accrues 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—

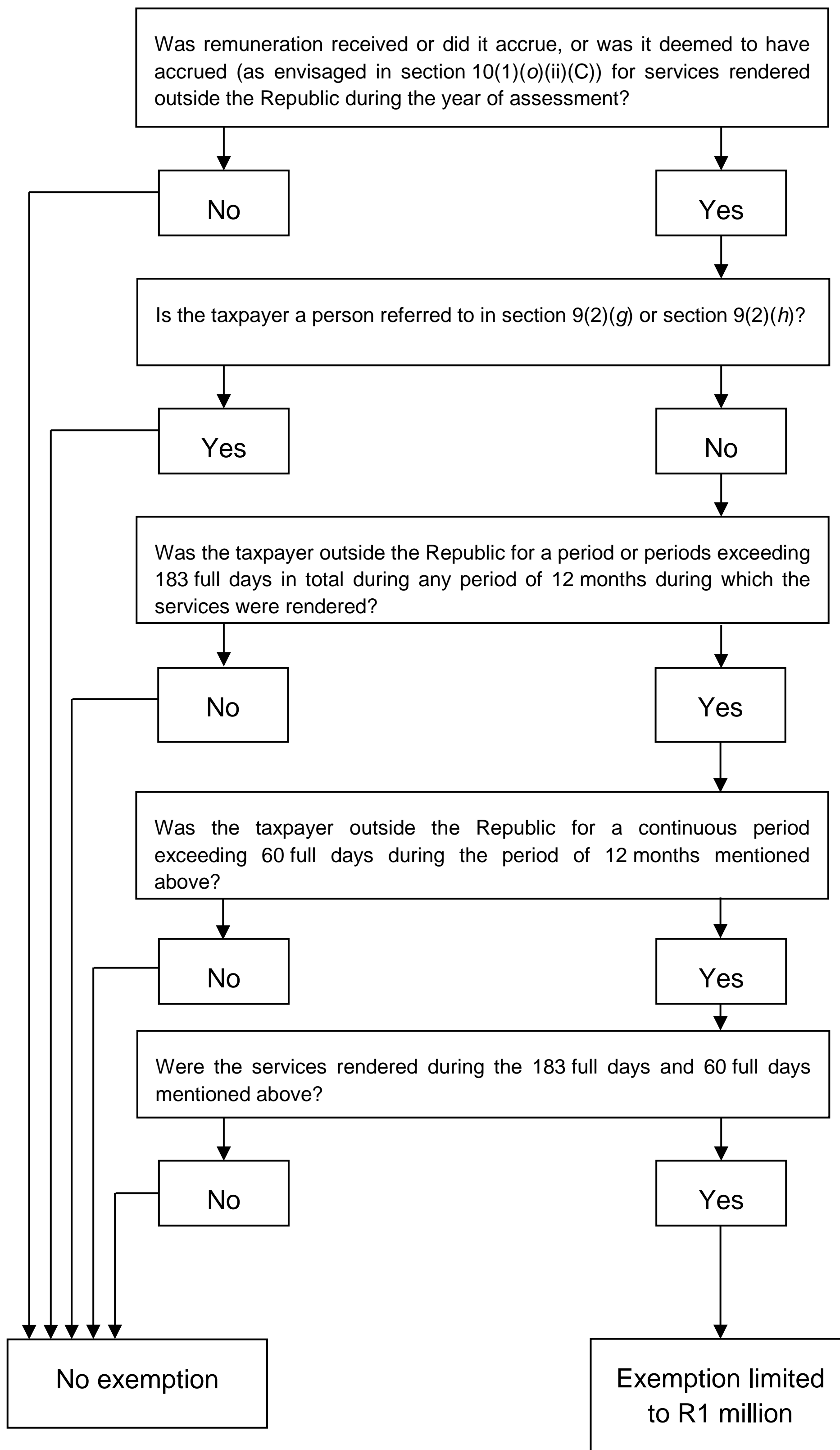
(AA) derived in respect of the holding of a public office contemplated in section 9(2)(*g*); or

(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;

Annexure B – Diagram

Basic steps to be followed in determining the exemption



Annexure C – Comparison between section 10(1)(*o*)(i), (iA) and (ii)

Relevant aspect	Section 10(1)(*o*)(i)	Section 10(1)(*o*)(iA)	Section 10(1)(*o*)(ii)
Remuneration	As defined in paragraph 1 of the Fourth Schedule to the Act.	As defined in paragraph 1 of the Fourth Schedule to the Act.	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(1) or an amount referred to in section 8, 8B or 8C.
Employee	Item (*aa*): *Any* officers and crew members, excluding an independent contractor or self-employed person.	*Any* officers and crew members, excluding an independent contractor or self-employed person.	*Any* employee, excluding an independent contractor or self-employed person.
	Item (*bb*): *Only* officers or crew members solely employed for the navigation of the ship, excluding an independent contractor or self-employed person.		
Employer	Resident or non-resident employers.	Resident or non-resident employers.	Resident or non-resident employers.
Qualifying ship	Any ship (international or South African) engaged in a specified activity (see below).	South African registered ships as defined in section 12Q(1) mainly engaged in a specified activity (see below).	N/A
Activities of ship	Item (*aa*): international transportation for reward of passengers or goods.	Item (*aa*): international shipping as defined in section 12Q(1), meaning the conveyance for compensation of passengers or goods by means of the operation of a South African ship mainly engaged in international traffic.	N/A
	Item (*bb*): prospecting, exploration or mining for or production of any minerals (including natural oils) from the seabed outside the Republic.	Item (*bb*): fishing outside the Republic.	
Qualifying period	During a year of assessment	During a year of assessment	During any 12 month period

Relevant aspect	**Section 10(1)(*o*)(i)**	**Section 10(1)(*o*)(iA)**	**Section 10(1)(*o*)(ii)**
Outside the Republic	Item (*aa*): Beyond the territorial waters (that is 12 nautical miles from the baselines) for any officer or crew member.	Item (*aa*): Beyond the territorial waters (that is 12 nautical miles) for any officer or crew member.	Beyond the territorial waters (that is 12 nautical miles) for any person rendering employment services; which may include— • any officer or crew member employed on a ship engaged in prospecting, exploration, mining or production of or for minerals **but** not employed for the navigation of the ship or for the exploration or exploitation of natural resources; or • any officer or crew member employed on a South African ship mainly engaged in fishing but not employed for the exploitation of natural resources.
	Item (*bb*): Beyond the edge of the continental shelf or 200 nautical miles, whichever is the greater for an officer or crew member navigating the ship.	For purposes of item (*bb*): Beyond the edge of the continental shelf or the EEZ (for any officer or crew member, depending on the type of fishing done.	Beyond the edge of the continental shelf (that is 200 nautical miles) for any person or officer or crew employed for the exploration or exploitation of natural resources.
Days requirement	For a period or periods exceeding 183 full days in aggregate during a year of assessment.	No days requirement during a year of assessment.	For – • a period or periods exceeding 183 full days in aggregate during any period of 12 months; and • for a continuous period exceeding 60 full days during that period of 12 months.
Apportionment required?	No	No	Yes, to the extent that services are rendered outside the Republic.