

**A critical analysis of whether the current legislated
exit tax provisions of South Africa are proportional to
the legitimate purpose of those provisions**

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ABSTRACT

When a South African taxpayer transfers his/her residence to another tax jurisdiction, exit tax is levied on certain accrued gains on the basis that a termination of residency results in a deemed disposal. This creates a fiction that the taxpayer disposes of his/her assets even though there was no change in ownership. It is likely that the levying of exit will create a cash flow disadvantage for the taxpayer, because there is a cash outflow, but no cash inflow. Moreover, the South African exit tax provisions require that exit tax is paid immediately upon emigration.

The “immediate recovery” method of exit tax has raised a number of questions regarding the proportionality vis-à-vis the legitimate purpose of exit tax.

Derived from Adam Smith’s first maxim, a tax is considered to be proportional to its purpose if the content and form of the tax does not go beyond what is required to attain the purpose of the tax. This principle is commonly known as the *principle of proportionality*. Proportionality is also one of the fundamental principles in the European Union (‘EU’) and has featured in a number of European court cases concerning exit tax.

This minor dissertation seeks to analyse the current legislated exit tax provisions for South Africa and evaluates whether these provisions are proportional to the purpose of exit tax or goes beyond what is necessary to achieve its purpose.

The key findings arising from the research presented in this minor dissertation is that an exit tax regime which require an emigrating individual to immediately pay exit tax upon departure may restrict the mobility of that individual and prevent him/her from relocating to another tax jurisdiction. This dissertation found that such a restriction is not proportional to the purpose of exit tax.

The mere imposition of exit tax may be justifiable and that it is not so much the principle of levying exit tax that cause concern, but more the timing and method of the application of exit tax.

In South Africa, exit tax is due immediately upon departure. In line with the key findings in this dissertation, the current legislated exit tax provisions for South Africa is not proportional to the purpose of such provisions.

Other countries have already addressed this issue by implementing alternative measures to levy and collect exit tax which is less burdensome for the taxpayer and therefore considered to be proportional to the purpose of exit tax. One such method is the deferral of exit tax until the point of actual realisation of the accrued gains.

Following the analysis as described above, this dissertation finally evaluates the effectiveness of the current legal framework for information exchange and assistance in tax collection in a South African context in order to determine whether the adoption of a method whereby exit tax is deferred and collected upon actual disposal of the asset, is viable in South Africa.

This evaluation found that South Africa already have the appropriate legal mechanisms in place in order to collect exit tax debt from a former resident.

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CHAPTER 1: INTRODUCTION

1.1. Background

In a globalized world, taxpayers migrate for a variety of tax-related and non-tax related reasons. The basic rationale behind exit tax is the recoupment by a country of the benefits and protections offered while the person or company was a resident.¹ In other words, exit tax protects the tax base of the former resident state.² A change of residence for tax purposes gives rise to the concern that the former state of residence may lose the taxing power in respect of the taxpayer's wealth generated during the taxpayer's period of residence.³ As a result, the unrealised increase in the value of asset owned by the taxpayer while he/she was a resident of the former state, is taxed by that state before emigration.

On 23 February 2000, exit tax was announced in South Africa as part of the introduction of capital gains tax ('CGT') and took effect on 1 October 2001.⁴ This exit tax is imposed on taxpayers when they terminate residence and can be found in section 9H of the Income Tax Act No.58 of 1962 ('the Income Tax Act').⁵

In general, exit tax may be imposed on individuals as well as corporations. This dissertation has as its focus the exit tax implications resulting from a change of residence of an individual and does not address exit tax pertaining to companies and trusts.

When a South African taxpayer transfers his or her residence, exit tax is levied on certain gains on the basis that the transfer of residency results in a deemed disposal. This creates a fiction that a taxpayer disposes of his assets even though there was no change in ownership of the assets. Consequently, the levying of exit tax is likely to create

¹ J. Li and F. Avella, Article 13: Capital Gains - Global Tax Treaty Commentaries, (Global Tax Treaty Commentaries IBFD), available online from https://online-ibfd-org.ezproxy.uct.ac.za/document/gttc_article13.

² South African Revenue Service, "Comprehensive Guide to Capital Gains Tax," (Issue 5), 109.,('The CGT Guide'). Also see the Global Tax Commentaries on Article 13.

³ An exemption applies, briefly speaking, to assets that effectively remain connected with South Africa after emigration.

⁴ Refer to page 8 of the Budget Speech delivered by the Minister of Finance on 23 February 2000.

⁵ With effect from 1 April 2012 the exit tax provisions were moved from the Eight Schedule of the Income Tax Act to section 9H of the Income Tax Act.

a cash-flow disadvantage for the taxpayer as he/she is required to pay exit tax immediately upon emigration.

Adam Smith constructed four maxims of taxation for public funding which can be used to evaluate a tax system.⁶ This is a widely agreed-upon set of principles and although it was constructed over two hundred years ago, it is commonly used as a precursor to the same principles applied by today's tax experts. Smith's maxims are universal and internationally used as a benchmark to evaluate tax systems. The Katz Commission and Margo Commission are two examples where Smith's maxims have been considered and applied in a South African context in the past.⁷ Most economists at some point refer to Smith's maxims of taxation when making decisions.⁸ The former Prime Minister of the United Kingdom ('UK'), Gordon Brown, for example, announced that he had Adam Smith's maxims at his side while preparing the 2002 Budget.⁹ Even though Smith's maxims were written over two hundred years ago, they are still relevant today and remain as a general point of departure as was evident in the Margo and Katz Commission reports.

The most pertinent of Smith's maxims is his first one:

"The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."¹⁰

This suggests that tax should be levied on citizens on the basis of equality. In other words, the tax burden should be proportional to the benefit a person enjoys as a result of residing in a specific country.

⁶ A. Smith and J.R. McCulloch, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Adam and Charles Black, 1872), 639.

⁷ R. W. Vivian, "Equality and Personal Income Tax—the Classical Economists and the Katz Commission," *South African journal of economics* 74, no. 1 (2006): 79.

⁸ Ibid.

⁹ I. Mclean, "Adam Smith and the Modern Left," (2005), available online from <https://www.nuffield.ox.ac.uk/politics/papers/2005/mclean%20smith.pdf>.

¹⁰ Smith and McCulloch, 639.

Furthermore, it is commonly known that the *Ability-to-pay* principle is reflected in Smith's first maxim by requiring citizens to contribute to government "*in proportion to their abilities.*"

The Ability-to-pay principle can equally be construed as a principle of proportionality.

The principle of proportionality has been described as a legal principle, meaning, in plain English:

*"You must not use a steam hammer to crack a nut, if a nutcracker would do."*¹¹

The principle of proportionality is also one of the fundamental principles of the EU:

*"In the context of EU law, an infringement of the principle of equal treatment through discrimination or the imposition of a restriction is prohibited unless there is a justification for the infringement. Such a justification must be proportionate, meaning that the measure must be appropriate to the objective in question and must not go beyond what is necessary to achieve that objective (article 5 of the Treaty on European Union). In considering whether or not a measure is proportionate, consideration must be given to whether or not less restrictive means of achieving the objective are available."*¹²

This means that the principle of proportionality can serve as a mechanism to judge whether a measure has gone beyond what is required to attain a legitimate goal and whether its claimed benefits exceeds the costs.

Proportionality was dealt with in the text of the South African interim Constitution of 1994¹³ – the early jurisprudence of the Constitutional Court. Some academics are of the view that proportionality is a prominent feature of the application of the limitation clauses in the South African Constitution and the elements of proportionality provides a useful tool for the application, within the context of the limitation of rights, of the general and wide concepts such as "reasonableness", "fairness", and of the general

¹¹ *R v Goldstein*, 1 WLR, para 151,55 (1983).

¹² IBFD's International Tax Glossary.

¹³ The Interim Constitution was approved in Kempton Park and it was duly endorsed by the last apartheid Parliament and became the Constitution of the Republic of South Africa, Act 200 of 1993.

concept “proportionality” as such.¹⁴ On this basis it said that South Africa participates in the global recognition and application of the principle of proportionality.

The South African exit tax regime operates on a “pay-now” basis since the taxpayer is required to pay exit tax immediately upon emigration. This may present severe problems of liquidity for the taxpayers and as a result, the taxpayer may be forced to sell all or a portion of his or her assets in order to pay exit tax. The “immediate recovery” method of collecting exit tax may restrict the individual from leaving South Africa. This method has raised a number of questions regarding the proportionality of the collection method vis-à-vis the legitimate purpose of exit tax because of the restriction.

Considering the restriction in the light of Smith’s first maxim and the principle of proportionality, the question is whether the current method of levying and collecting exit tax in South Africa is going beyond what is required in order to achieve the purpose of exit tax, i.e. going beyond what is regarded as proportional and justifiable.

Exit tax is part of the tax system of many OECD¹⁵ countries and has been considered in a number of European court cases where the European Court of Justice (‘ECJ’) found that exit tax may not be levied in an unrestricted manner mainly due to the cash flow disadvantage which causes an infringement of the freedoms provided in the Treaty on the Functionality of the European Union (‘TFEU’).¹⁶ As a result, many EU Member States adopted alternative methods to levy and collect exit tax, which ultimately results in the taxpayer paying exit tax on the actual disposal of the asset. These cases were, however, considered in the light of the European Community (‘EC’)¹⁷ Law on the basis that exit tax undermines the principle of freedom of movement within the EU. It must be mentioned that this principle does not apply between EU Member States and non-Member States.

Although the imposition of exit tax by EU Member States have been justified by the ECJ by the balance of allocation of taxing powers of EU Members States and the principle of

¹⁴ I. M. Rautenbach, "Proportionality and the Limitation Clauses of the South African Bill of Rights," *Potchefstroom Electronic Law Journal* 17, no. 6 (2014): 1.

¹⁵ The Organisation for Economic Cooperation and Development (‘the OECD’)

¹⁶ G. Maisto, *Residence of Individuals under Tax Treaties and Ec Law* (IBFD Online, 2010), 41.

¹⁷ Nowadays the European Community has evolved into the European Union.

fiscal territoriality,¹⁸ the ECJ has repeatedly held that exit tax is only proportional when there is an automatic deferral of the tax and the tax is only due upon the actual realisation of assets (subject to exit tax).

South Africa is not a member state of the EU and as such, these principles are not applicable in South Africa. This notwithstanding, it is important to consider international principles and precedent with respect to exit tax, especially the EU's overall treatment of exit tax.

This minor dissertation will attempt to assess whether the “pay-now” basis for exit tax imposed upon emigrating individuals is proportional to the legitimate purpose of those taxes.

Where it is found that the exit tax provisions of South Africa are not proportional to the purpose of exit tax, this paper will attempt to put forward recommendations on how this can be addressed through the examination of the alternative solutions offered by other countries, including EU Member States.

1.2. Research question and scope

The aim of this dissertation is to assess whether the current legislated exit tax provisions of South Africa is proportional to the legitimate purpose of exit tax. If it is determined that the current exit tax provisions go beyond what is necessary to attain the purpose it pursues, this dissertation aims to identify measures that can be implemented to restore the balance between the purpose of exit tax and the manner in which exit tax is levied and collected.

This dissertation therefore address the following issues:

- i. the historical and current rationale behind exit tax;

¹⁸ *“This term is used in the context of international taxation to connote the principle of levying tax only within the territorial jurisdiction of a sovereign tax authority or country. The underlying theory is that no taxes can be levied outside this area without violating the sovereign tax authority of another state. Consequently, both residents and non-residents of a state adopting this principle are only taxed on the income from sources in that country and on property situated in that country. Residents are not normally taxed on any foreign-source income (sometimes, however, subject to anti-avoidance measures). The term may also refer to the principle that a state has the right to tax all persons, property or activity within its borders. The term is also used in a similar way in the context of EU direct taxation, although the precise meaning appears still to be evolving.”* – See IBFD Glossary.

- ii. whether the South African exit tax provisions promote the Ability-to-pay principle as embedded in Adam Smith's first maxim - in other words, does the current legislation with respect to the levy and collection of exit tax go beyond what is necessary to achieve the objective of the exit tax?
- iii. if the exit tax creates a disproportionate burden relative to the purpose of exit tax, would alternative measures (which is less burdensome) used by other jurisdictions offer solutions to resolve this issue?
- iv. would such solutions or alternative measures be viable in South Africa?

The analysis will be confined to exit tax levied on individuals only and will not address the legislation when applied to companies and trusts, albeit that some of the findings may be equally applicable in certain cases.

1.3. Research method

The scope of this dissertation encompasses qualitative research of a doctrinal and comparative nature. This research begins with a "doctrinal" or "black letter law" methodology as some of the research is based on analysing the existing exit tax provisions of South Africa as well as other countries in the context of the principle of proportionality through examination of cases as well as existing literature. Data consulted is primarily textual, which includes the Income Tax Act, historical studies, foreign case law, EU law, OECD publications, and various opinions stated in articles by South African and international researchers. This approach enables the researcher to critically analyse the workings of exit tax provisions and whether exit tax is a proportional burden relative to the legitimate purpose for the collection of such taxes.

An examination of the so-called "deferral method" which is adopted by different EU Member States and other non-Member States, will lead the researcher to look beyond the black letter law. EU Member States (as well as non-EU Member States) offer various measures to levy and collect exit tax from emigrating individuals, which is believed to be less burdensome and, more importantly, proportional to the purpose of exit tax. This dissertation therefore adopts a comparative method, as a means of evaluating the different methods adopted by those countries and furthermore evaluate whether those methods are viable in a South African context.

Where it is found that the current legislated exit tax provisions of South Africa are not proportional, this dissertation puts forward recommendations based on the findings of the comparative study.

1.4. Structure of this paper

This dissertation is divided into six chapters. Chapter two explains the rationale behind exit tax as well as the nature and workings of South African exit provisions. Chapter three explains and discusses the theoretical principles with a view to ascertain whether the legislated exit tax provisions for South Africa adhere to the principle of proportionality. This chapter therefore analyses the exit tax regime for South Africa from a principled perspective and concludes that the current exit tax provisions for South Africa creates a burden which is disproportional to the legitimate purpose for the collection of such taxes.

Chapter four describes the exit tax regimes applied in general by EU countries as well as non-EU countries. Chapter four not only assesses the practical issues these countries considered in respect of their own exit tax regimes, but also explores solutions and alternative measures offered in respect of the levy and collection of exit tax which have been found to be less restrictive for the taxpayer and, hence, proportional to the purpose. More specifically, this chapter explores the deferral method adopted by many EU Member States in respect of the recovery of exit taxes from former residents.

Chapter five evaluates whether an alternative measure such as the so-called “deferral method” can in fact be adopted in South Africa to levy and collect exit taxes by evaluating the current legal framework for information exchange and assistance in tax collection in order to determine whether the South African Revenue Services (‘SARS’) would be able to collect exit tax from a former resident while residing in another country. Chapter five provides statistics of South African emigrants over the past 10 years and shows that the highest proportion of emigrants relocated to Australia, the UK and the United States of America (‘US’). Furthermore, chapter five makes reference to the current exchange of information and assistance in collection mechanisms that exist between South Africa and these three aforementioned destination countries in order to determine whether the SARS has sufficient mechanisms in place to successfully adopt a deferral method similar to what is applied by EU Member States.

The final chapter sets out conclusions drawn from the analysis in the preceding chapters.

CHAPTER 2: ORIGIN AND PURPOSE OF EXIT TAX

2.1. Rationale behind exit tax

The basic rationale behind exit tax is the recoupment by a country of the benefits and protections offered while the person was a resident in that specific country.¹⁹ The former country of residence ('emigration country') may lose a substantial portion of its tax base when prior untaxed accrued income and appreciation in the value of movable property, which the taxpayer will normally take with him /her, is not included in the tax base of that country.²⁰ Some commentators are of the view that exit tax is in essence an anti-avoidance measure and not necessarily a penalty imposed for the loss of future revenue²¹ and that a "*penalty provision*" will only exist when exit tax leads to double taxation which is not relieved in terms of the domestic law or a Double Tax Agreement ('DTA').²² If exit tax is used to prevent taxpayers from leaving the country purely so that they may realise their capital assets in a jurisdiction which have lower, or no CGT, this tax may very well serve as a useful anti-avoidance mechanism.²³

2.2. History and working of South African exit tax provisions

The term "exit tax" may suggest that this is a tax separate from income tax. This is, however, not the case because South African exit tax provisions were introduced when CGT was first introduced in South Africa, which took effect on 1 October 2001. CGT is not a separate tax and is regarded as a tax on income. CGT was incorporated in the Income Tax Act through section 26A:

"There shall be included in the taxable income of a person for a year of assessment the taxable capital gain of that person for that year of assessment as determined in terms of the Eighth Schedule."

Accordingly, exit tax forms part of a taxpayer's income tax liability.

¹⁹ Li and Avella.

²⁰ L. De Broe, "General Report" In: *International Fiscal Association, 2002 Oslo Congress, Cahiers De Troit Fiscal International, "the Tax Treatment of Transfer of Residence by Individuals"* (New York: Kluwer Law International 1992), 23.

²¹ M. Honiball, *International Tax* (Siber Ink Publishers, 2011), 44.

²² Ibid.

²³ Barry Ger, "Sars Overreacts after Sca Decision on Exit Taxes," (2012), [available at <http://www.thesait.org.za/news/112537/SARS-Overreacts-After-SCA-Decision-On-Exit-Taxes.htm>](http://www.thesait.org.za/news/112537/SARS-Overreacts-After-SCA-Decision-On-Exit-Taxes.htm).

Exit tax is imposed on unrealised gains (i.e. the increase in the value of the asset) with respect to certain assets owned by a person who becomes a non-resident. Exit tax is calculated as the difference between the market value (on the day of emigration) and the base cost of the asset.²⁴ Certain rules exist in the Eighth Schedule for determining the base cost of an asset.²⁵ These rules are not elaborated upon in this dissertation.

The first exit tax provisions for South Africa were located in paragraph 12 of the Eighth Schedule.²⁶ Section 9H was introduced into the Income Tax Act to consolidate exit tax rules applicable when a person ceases to be a resident for South African income tax purposes.²⁷ As a result of a decision taken by the Supreme Court of Appeal ('SCA') in the matter *CSARS v Tradehold Limited*,²⁸ exit tax provisions were amended in order to prevent the outcome achieved in this case.²⁹

In *CSARS v Tradehold Limited*, an investment holding company incorporated and resident in South African, became effectively managed in Luxembourg on 2 July 2002 when it was decided that all future board meetings will be held in that country. During the 2002 year of assessment, Tradehold Limited's ('Tradehold') only relevant asset was its 100% shareholding in Tradegro Holdings which also held 100% of the shares in Tradegro Limited, a company incorporated in Guernsey.

When Tradehold became effectively managed in Luxembourg, it also became exclusively resident in Luxembourg in terms of the DTA signed between South Africa and Luxembourg. Tradehold, however, remained a resident of South Africa because of the definition of "resident" at that time.³⁰

²⁴ See paragraph 20 of the Eighth Schedule.

²⁵ See paragraph 20 of the Eighth Schedule.

²⁶ Eighth Schedule of the Income Tax Act.

²⁷ Section 9H came into operation on 1 April 2012.

²⁸ *Commissioner for South African Revenue Service V Tradehold Ltd*, 74 South African Tax Case 263 (2012).

²⁹ On 5 July 2012, draft legislation was released proposing various amendments to Section 9H. These amendments took effect on 8 May 2012 - see C. West and J. Roeleveld, "Chapter 4: South Africa: Transfer of Seat and Exit Taxation: Treaty Override? In Tax Treaty Case Law around the Globe," (2012).

³⁰ At that time, "resident" meant a "person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic (but excluding any international headquarter company)". This definition was then amended to add the following: "but does not include any person who is deemed to be exclusively a resident of another country for the purposes of the application of any agreement entered into between the government of the Republic and that other country for the avoidance of double tax". The amendment became effective on 26 February 2003.

The amendment to the definition of a “resident” to exclude any person who is deemed to be exclusively a resident of another country for the purpose of the application of any DTA, resulted in Tradehold being deemed to have disposed of its only asset, namely its 100% shareholding in Tradegro Limited. As a result, the SARS imposed a taxable capital gain of R405 million in terms of paragraph 12(1) of the Eighth Schedule for the 2003 year of assessment.

Tradehold objected to the assessment on the basis that it is a resident of Luxembourg and Article 13(4) of the DTA signed between South Africa and Luxembourg provided that capital gains arising from the disposal of property, shall only be taxed in the state of which the alienator is a resident. Having been disallowed the objection, Tradehold appealed to the Tax Court. The Tax Court found in favour of Tradehold. Consequently, the SARS appealed to the SCA which then upheld the decision of the Tax Court.

The issue that was contemplated by the SCA was whether a deemed disposal provided for in paragraph 12(1) of the Eighth Schedule is an “alienation” as envisaged in Article 13(4) of the DTA between South Africa and Luxembourg. The SCA found that the Article 13(4) of the DTA became effective from 2 July 2002 when the place of effective management was moved to Luxembourg, resulting in Luxembourg having exclusive right to tax all capital gains. The SCA further held that a “deemed disposal” in terms of the DTA is not restricted to an actual disposal. The SARS imposed the exit tax at the end of the 2003 year of assessment. Tradehold was exclusively resident in Luxembourg from 2 July 2002 and the capital gain could therefore not be taxed in South Africa at the time it was imposed.

The judgement does not specify the date on which the deemed disposal was deemed to have taken place. At that time, the Income Tax Act did not make reference to the year of assessment ending on the date a taxpayer ceases to be a resident. Generally, DTA protection on a change of residence during a tax year should be split between the two countries, based on the date of that change.³¹ On the day immediately preceding a change in residency, the taxpayer is still a resident of the emigration country. DTA protection should therefore not apply to capital gains which accrued to the taxpayer on the day immediately preceding a change in residence.

³¹ Ibid.

The timing of change of residence was not pursued by counsel for the Commissioner, but rather the argument that the scope of Article 13(4) of the DTA did not include deemed disposals. In this case, it seems that the deemed disposal was only considered to arise on 26 February 2003 when Tradehold Limited ceased to be a resident as a result of the amendment to the definition of “resident”. If the counsel for the Commissioner argued that the change of residency under that DTA occurred on 2 July 2002 (when the place of effective management shifted to Luxembourg), the time of disposition would have been 1 July 2002 in terms of paragraph 13(1)(g)(i) of the Eighth Schedule. Tradehold Limited would not have been subject to DTA protection on this day.

Section 9H of the Income Tax Act was amended to end the year of assessment on the day before the taxpayer ceases to be a resident. The amendment made it clear that a taxpayer cannot make use of DTA protection in respect of exit tax when residency ceases.

Section 9H applies in the following instances:

- i. an individual or trust ceases to be a resident of South Africa;³²
- ii. a company ceases to be a resident of South Africa;
- iii. a resident company becomes a headquarter company; or
- iv. a controlled foreign company ceases, otherwise than by becoming a resident, to be a controlled foreign company.

Subsection 2(a) of section 9H sets out the tax consequences where a person (other than a company) who is a resident, ceases to be a resident of South Africa:

“[t]hat person must be treated as having-

- (i) disposed of each of that person’s assets to a person that is a resident on the date immediately before the day on which that person so ceases to be a resident for an amount received or accrued equal to the market value of the assets on that date; and*

³² This thesis will only elaborate on the tax consequences when an individual ceases to be a resident of South Africa.

- (ii) reacquire each of those assets on the day on which that person so ceases to be a resident at an expenditure equal to the market value contemplated in subparagraph (i)."*

The definition of the term "asset", as contemplated in section 9H, means "asset" as defined in the Eighth Schedule.³³ The Eighth Schedule determines that the term "asset" includes any property, whether movable or immovable. Subsection 4 of section 9H sets out the circumstances in which section 9H will not apply.³⁴

- i. immovable property situated in South Africa that is held by the taxpayer ceasing to be a resident;
- ii. any asset which is, after the person ceases to be a resident or a controlled foreign company, attributable to a permanent establishment of that person in South Africa;
- iii. any qualifying equity share contemplated in section 8B that was granted to that person less than five years before the date on which that person ceases to be a resident;
- iv. any equity instrument contemplated in section 8C that had not yet vested as contemplated in that section at the time that the person ceases to be a resident;
or
- v. any right of that person to acquire any marketable security contemplated in section 8A.

It is clear that an exit tax will only be imposed on those assets that do not remain within or are removable from South Africa. In respect of immovable property,³⁵ the taxpayer is not deemed to have disposed of such assets for the purpose of section 9H. Once these assets are sold by the non-resident in the future, the disposal will be subject to South African tax (subject to DTA relief). The rationale behind such treatment is that the immovable property assets naturally remain within the borders of the emigration country and thus under its control.

³³ See paragraph 1 of the Eighth Schedule.

³⁴ Section 9H(4) of the Income Tax Act

³⁵ The Eighth Schedule nor the Income Tax Act defines the term 'immovable property'. The CGT Guide provides examples of immovable property which includes land, buildings, trees etc. Some clarification is also provided in paragraph 2(2) of the Eighth Schedule which sets out the definition of the term 'interest in immovable property'.

2.3. General issues associated with exit taxes

In order to fully understand the exit tax regime, it is necessary to also understand the issues typically experienced by taxpayers when it comes to exit tax. The following sections explain, in general, the practical issues in respect of the levying and recovering of exit tax from taxpayers who are relocating to a foreign tax jurisdiction.

2.3.1. Liquidity problems as a result of a deemed disposal

The main criticism against the imposition of exit tax is that the taxpayer is required to pay tax on a gain which has not actually been realised for income tax purposes since there was no change in ownership. Moreover, when an individual relocates from South Africa, he/she is required to pay exit tax immediately upon emigration. As a result of the deemed disposal the taxpayer may, at times, be necessitated to sell a portion (or all) of his/her assets in order to achieve the liquidity to pay the SARS.

Planning is thus critical when a taxpayer decides to emigrate. The reason, from a cash flow perspective, is that if the taxpayer has many assets which do not remain within the South African CGT ambit, the taxpayer will be deemed to have disposed of all those assets. It should be noted that the Eighth Schedule excludes capital gains and losses on personal use assets, even when such assets are disposed of.³⁶ The most significant items that will therefore be subject to the deemed disposal rules (and exit tax) are financial instruments and business assets.

Upon emigration that taxpayer will be obliged to pay CGT on his worldwide assets,³⁷ despite no physical disposal of such assets having taken place. It is therefore particularly the foreign assets owned by the taxpayer which may cause aggravation. Especially if such assets were either inherited or purchased with capital generated from foreign sources, i.e. funds that were not earned within the source country and taken offshore for investment.

Considering South African exit tax provisions, it can be concluded that the only logical explanation why exit tax is payable immediately upon emigration is due to the administration difficulties that will arise should the exit tax only be collected after

³⁶ This is discussed in chapter three.

³⁷ South Africa levy tax on worldwide income.

emigration. The SARS would have a difficult time to administer and monitor the disposal of foreign assets by former residents who emigrated to a foreign country.

2.3.2. Valuation of assets on the day of the deemed disposal

In terms of South African exit tax provisions, exit tax is determined based on the market value of the relevant assets on the day immediately before residency ceases. Valuations of assets may very well be a complex and expensive exercise depending on the nature of the assets. In addition, it can be administratively impractical to value a wide range of property at the time of emigration.

2.3.3. Potential double taxation

Since an exit tax is in essence a country's expression of "*its fiscal sovereignty by taxing unrealized capital gains and hidden reserves*,"³⁸ from an international perspective, the transfer of a residence by an individual can result in issues of allocation of taxing powers between the emigration country and the immigration country (country of new residence). Double taxation mainly arises in the event that the taxpayer has not been granted a step-up in the tax base of the asset upon migration, or if the immigration country does not grant a credit to offset its tax liability in the emigration or immigration country. A step-up in the tax base of the asset is discussed in more detail in section 2.3.5 below.

Countries impose exit tax for various reasons. Moreover they apply different methods to levy and collect the exit tax. Logically this increases the risk of double taxation. Potential double taxation mainly arise when it comes to DTAs (which is the concrete provisions of international tax law) as exit tax is not neutral in terms of the allocation of the taxing powers normally established in the DTA. In addition, exit tax is imposed in general without regard to the tax system of the immigration country.

Even though it is evident that double taxation may be caused by exit tax, some commentators question the underlying source of double taxation and "*put forward the query as to whether the cause of double taxation is (i) the levy of immediate exit tax by the*

³⁸ D. Zernova, Exit Tax on Companies in the Context of the Eu Internal Market, (HeinOnline). 471.

former state of residence or (ii) the lack of a rebasing or a method to relieve double taxation by the new state of residence.”³⁹

Furthermore, critics are of the view that double taxation caused by exit tax may impair a taxpayer’s ability to bear a tax burden and therefore his/her ability to relocate to another jurisdiction. A taxpayer has to have the ability to bear a tax and not only the ability to pay it.⁴⁰

Taxpayers subject to international double taxation after emigration will have to rely on relief methods provided for either in the DTA or the domestic law of the immigration country or emigration country (depending on the tax systems).

2.3.4. Different views on taxing unrealized gains

The OECD Commentaries on Article 13⁴¹ of the OECD Model Convention explains that there are generally three moments when capital gains are taxed: (i) when alienation of property takes place, (ii) when there is a realisation of property, and (iii) when there is capital appreciation of property.

The general argument is that exit tax falls within the scope of Article 13 of the OECD Model Convention since there is nothing in Article 13 that would impede a country from taxing unrealised gains.

Some commentators try to build a counter argument using the term “alienation” which means that only transactions that result in an actual alienation (i.e. change in ownership) of property could be subject to tax and that Article 13 will impose a restriction on countries that intend to tax capital gains that are not derived from alienation transactions.

Holmes is also of the view that income must be realised before it can legally be regarded as taxable income:

³⁹ B.M. Carramaschi, "Exit Taxes and the Oecd Model Convention," *Tax Notes International* 49, no. 3 (2008): 12.

⁴⁰ Vivian, 102.

⁴¹ 2014 OECD Commentaries, para 2 on Article 13.

“Given the historical evaluation of the concept of capital, the courts reasoned that income must be something that is severed from the capital that produces it. This, a gain must be realized before it can be treated as income in the legal sense.”⁴²

Austria supports this view in arguing that the alienation requirement demands a change in ownership.⁴³

It is obvious that commentators have different and conflicting views in respect of taxing unrealised gains.

2.3.5. Providing for a step-up in the tax base of the asset

Section 9H stipulates that the emigrating taxpayer will reacquire each of the relevant assets on the day which the person ceases to be a resident at an amount equal to the market value of the relevant assets. In effect, this creates a step-up in the value of the asset because the reacquired value will become the new tax base of the asset.

If there is no step up in the value of the asset, the immigration country will impose tax on the portion of the gain which was already taxed in the emigration country, which will result in double taxation. If the immigration country allows for a stepped up cost base, there ought to be no double taxation.

A step-up provision can therefore certainly be useful for non-residents entering an immigration country. The issue is, however, that section 9H cannot bind other tax jurisdictions to the use of the stepped up base cost.⁴⁴ The immigration country is not legally required (by section 9H) to regard the “stepped up value” (market value) as the new tax base of the asset when the taxpayer enters the immigration country.

Countries applying a comprehensive CGT system, such as South Africa and Canada, generally provide for an automatic step-up in the tax base of the asset when a person becomes a resident for tax purposes.⁴⁵ As explained above, the main issue in this regard is that a mismatch in the tax base of the asset may arise in the event of the emigration

⁴² K. Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD Online, 2001), 178.

⁴³ K. Vogel, *Klaus Vogel on Double Taxation Conventions*, 4th ed. (Zuidpoelsingel, Netherlands: Kluwer Law International, 2015), 1082.

⁴⁴ Countries other than South Africa applying this method includes Canada and Australia – see De Broe, p 57.

⁴⁵ De Broe, 57.

country providing for a step-up in the tax base of the asset and the immigration country not allowing the stepped up value as the new tax base.

In DTA practice, there are mainly declaratory affirmations regarding the legitimacy of exit tax provisions in a narrow sense. Sometimes these affirmations are linked with a constitutive obligation for the immigration country to grant a step-up in the book value of the assets.⁴⁶ These provisions largely apply to shares in corporations. For instance in Article 13(6) of the DTA signed between Germany and Poland, the following applies:⁴⁷

“Where an individual was a resident of a Contracting State for a period of five years or more and has become a resident of the other Contracting State, paragraph 5 shall not affect the right of the first-mentioned State to tax under its domestic law the individual in respect of any capital appreciation of shares and other participations in companies resident in the first-mentioned State accrued up to the change of residence. If the first-mentioned Contracting State has taxed such appreciation at the time of the departure of a resident individual, the other Contracting State shall, upon a subsequent alienation of the shares in accordance with paragraph 5, in the determination of the amount of the capital gains, use as the acquisition cost the amount determined by the first-mentioned State at the time of the departure.”

In the said DTA, the new value of the asset assumed by the immigration country is referred to as the *“acquisition cost”*. In essence, an obligation is formed whereby the immigration country has to consider the fair market value and the amount taken as basis for the emigration country’s exit taxation.⁴⁸

Article 13(4) of the DTA signed between Canada and Chile limit the step-up in the asset value to only property that is not situated in either Contracting States:

“Where an individual who ceases to be a resident of a Contracting State, and immediately thereafter becomes a resident of the other Contracting State, is treated for the purposes of taxation in the first-mentioned State as having alienated a property and is taxed in that State by reason thereof, the individual

⁴⁶ Vogel, 1082.

⁴⁷ Ibid.

⁴⁸ Ibid., 1083.

may elect to be treated for the purposes of taxation in the other State as if the individual had, immediately before becoming a resident of that State, sold and repurchased the property for an amount equal to its fair market value at that time. However, the individual may not make the election in respect of property situated in either Contracting State.”

According to Vogel, the obligation for the immigration country to grant a step-up in the value of the assets occurs when the emigration country’s tax assessment takes place and, accordingly, actual collection is not required.⁴⁹

Denmark is an exception to this general rule:

“Denmark deems depreciable assets to be acquired upon immigration at their acquisition price but subject to a maximum depreciation under Danish law. If, however, such a net value is lower than the depreciated value under Danish law, the assets are deemed acquired at fair market value upon immigration.”⁵⁰

The Netherlands, on the other hand, only provides for a step-up in the asset value (only applicable to certain assets) upon the condition that a reasonable amount of exit tax was paid in the emigration country.⁵¹

Based on the above, there is no doubt that the issue of double taxation may emerge when the tax base value of the assets transferred is lower in the immigration country than is deemed in the emigration country.

2.3.6. Exit tax as an anti-avoidance measure

With the rapid opportunities presented by globalization, taxpayers are viewing the world as a global village and it is not surprising when the transfer of residence is tax motivated. Even more so if residence is transferred to a tax haven which may result in the taxpayer achieving a definite tax exemption.

A good example is when a taxpayer, owning substantial shareholding in a company that carries an accrued capital gain in them transfers his tax residence from a country that does not levy exit tax (but CGT on realisation of shares) to a country that has entered

⁴⁹ Ibid.

⁵⁰ De Broe, 57.

⁵¹ Ibid.

into a DTA with the emigration country that allocated the right to tax capital gains to the country of new residence (Article 13(4) of the OECD model). Considering these facts, one of the main purposes for the change of residence is tax avoidance for the realisation of the capital gain on the shares. An exit tax may overcome such avoidance.

According to paragraph 9 of the 2014 OECD Commentary on Article 1, if a taxpayer emigrates to another tax jurisdiction with the sole purpose to realise tax free capital gains, it can be viewed as an abuse of the DTA. Paragraph 22 of the same Commentary further explains that anti-abuse rules are part of domestic law and domestic law should determine the facts that give rise to a tax liability in an abusive situation.

The issue here is that exit tax provisions in almost all domestic exit tax regimes are not targeted at strictly abusive situations, as opposed to other anti-avoidance measurements on unrealized gains or income, e.g. controlled foreign company regimes.⁵²

If exit tax is considered to be an anti-avoidance measure, these provisions should be designed to prohibit taxpayers from obtaining a tax advantage through purely artificial arrangements aimed at circumventing the law. The current practice is aimed generally at any situation in which a taxpayer changes his residence and is not directed only at purely artificial arrangements.

2.4. Exit tax and the Constitution of South Africa

An argument exists in South Africa that exit tax levied in terms of section 9H is constitutionally incorrect.⁵³ Section 21 of the Constitution of South Africa⁵⁴ ('the Constitution') provides, *inter alia*, that everyone has the right to freedom of movement and the right to leave the country.

Even though this paper does not assess whether exit tax provisions are in conflict with the Constitution, it is necessary to note that unless the taxpayer can find funding for the exit tax obligation, he may not be able to afford to relocate elsewhere. The exit tax is in

⁵² Where abuse is evident as a result of a mismatch, the anti-abuse rules of the DTA will likely apply. A potential issue may arise in the event that the individual migrate to a country with which South Africa does not have a DTA.

⁵³ CGT Guide, 109.

⁵⁴ Constitution of the Republic of South Africa, 1996.

essence a negative factor towards the taxpayer's right to freedom of movement, as set out in the Constitution, on the basis that it may restrict his right to leave the country.

That being said, the general view is that section 36 of the Constitution provides a justification to the infringement on section 21 of the Constitution. It is held that the *"imposition of an exit tax protects the tax base and is therefore in the wider public interest and serves as a reasonable infringement on the right to freedom of movement"*.⁵⁵

There is a lack of jurisprudence in South Africa concerning this topic and it remains to be considered whether exit tax is in fact constitutionally incorrect.

2.5. Summary remarks

It is clear that the levy and collection of exit tax result in various issues for the taxpayer relocating to another tax jurisdiction. As mentioned already, the main criticism against exit tax is that the taxpayer is required to pay a tax on a "paper gain" (i.e. a gain which was not actually realised) which creates liquidity problems for the taxpayer. Moreover, South African exit tax provisions determine that when South African residence is terminated, the taxpayer is required to pay exit tax immediately upon emigration.

The "immediate recovery of exit tax" method may restrict an individual from leaving South Africa because he may be forced to sell a portion (or all) of his assets in order to pay exit tax. This restriction raised a number of questions regarding the proportionality of the collection methods vis-à-vis the legitimate aim of exit tax. The significance of this restriction has forced many countries to adopt alternative, less burdensome measure to levy and collect exit tax.

As put so eloquently in an Article published by Moneyweb:

*"The law as it stands seems rather harsh and unjust. A fairer provision would be for the capital gains tax liability to be calculated as at the date of departure, but only becomes due and payable when the asset is actually disposed of."*⁵⁶

⁵⁵ CGT Guide, 109.

⁵⁶ S. Jones, "Capital Gains Tax and Emigration," (2007), [available at <https://www.moneyweb.co.za/archive/cgt-and-emigration/>](https://www.moneyweb.co.za/archive/cgt-and-emigration/).

CHAPTER 3: ABILITY-TO-PAY AND THE PRINCIPLE OF PROPORTIONALITY

3.1. Meaning and origin of the Ability-to-pay principle

Tax systems today are enormous and complex and with that comes the issue of who must pay what in the name of which principle.

The Davis Tax Committee made the following remark in the First Interim Report on Macro Analysis for the Minister of Finance:⁵⁷

“...it is important to articulate a set of principles to evaluate the performance of the tax system...”

That being said, more than two hundred years ago Adam Smith, who is considered to be the father of modern political economy, put forward the famous four maxims of taxation in *The Wealth of Nations*:⁵⁸

“I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.

IV. Every tax ought to be contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.”

⁵⁷ Davis Tax Committee, "First Interim Report on Macro Analysis for the Minister of Finance: The Tax System and Inclusive Growth in South Africa," (December 2014), 12.

⁵⁸ Smith and McCulloch, 639.

Since Smith's theory was written over two hundred years ago, the question is whether these maxims can still be used to measure a modern and very complex tax system? By way of an example, maxim II requires certainty in every tax that each individual is obliged to pay. This means certainty to the man on the street and not just to the "tax profession". A society's tax system must be known and understood by all its members; otherwise, they cannot play their part to the full. Today, it is quite difficult for the man on the street to fully understand and calculate the different taxes he is obliged to pay, without employing the service of a tax specialist.

Clearly Smith's maxims were designed for a much simpler "tax" life, however, many economists and lawyers have re-interpreted Smith's canons of taxation in order for it to be applicable to modern taxation. It is in fact surprising how the basic simplicity is still applicable in complex, modern tax systems.

It is commonly accepted that the Ability-to-pay principle is reflected in Smith's first maxim. Ability-to-pay is a taxpayer's capacity to bear a tax.⁵⁹ The general principle implies that the greater a taxpayer's ability to pay, the higher the fair tax or fair rate of tax ought to be.

In the First Interim Report on Macro Analysis, the Davis Tax Committee highlighted the following principle as one of the main principles in designing a tax policy to achieve government objectives:⁶⁰

"[a]ll residents must contribute to the fiscus in proportion to their ability to do so. Both horizontal equity⁶¹ and vertical equity⁶² are important."

This statement is merely a re-interpretation of Smith's first maxim. Most commissions of taxation at some point referred to Smith's maxims when making decisions, see for

⁵⁹ S. Utz, Ability to Pay, (Faculty Articles and Papers at the University of Connecticut School of Law: HeinOnline, 2002). 867.

⁶⁰ The First Interim Report on Macro Analysis, 13.

⁶¹ Horizontal equity means "a variant of the principle of individual equity that holds that similarly situated taxpayers should receive similar tax treatment, e.g. taxpayers who earn the same amount of income or capital should be taxed in the same way" – See IBFD Glossary.

⁶² Vertical equity means "a variant of the principle of individual equity, which holds that differently situated taxpayers should be treated differently, e.g. taxpayers with more income and/or capital should pay more tax. This results in the proposition that 'appropriate' differences should be made between the tax treatment of taxpayers in different economic circumstances. The principle lies behind the imposition of tax at progressive rates." – See IBFD Glossary.

instance the Margo and Katz Commission.⁶³ Even the former Prime Minister of the UK, Gordon Brown, had Smith's maxims at his side while working on the 2002 Budget.⁶⁴ Many find a basic attraction to assessing a tax system in the manner found in Smith's first maxim. So much so, that even the Margo Commission report recognized that "*almost everyone subscribes to the ideal of taxation in accordance with the ability to pay.*"⁶⁵

Even though there is a universal agreement that the fairness of taxation is measured according to the Ability-to-pay principle,⁶⁶ there is also a broad understanding that the Ability-to-pay principle lacks a universally accepted meaning. It is, however, commonly accepted that the Ability-to-pay principle disregards any type of expenditure benefits by government services, but rather calls for the tax burden to be distributed on a fair basis. It is also commonly understood that income tax is the fairest tax because income reflects a person's ability to pay tax:

*"[t]he belief that the individual tax is the fairest of all taxes arises from the conviction that it accords best with ability to pay. Net income is a measure of a person's capacity to command economic resources, and, intuitively, it seems to be a good indicator of ability to help finance government."*⁶⁷

Adam Smith also observed that all taxes must eventually be paid out of income and as such are, in some sense, income taxes.⁶⁸ For practical implementation, it must be assumed that the ability to pay is sufficiently measurable.

The extensive discussions in the Margo and Katz Committee reports are a testimony to the practical importance and relevance of the Ability-to-pay principle. The Ability-to-pay principle is therefore part of the fundamental framework in judging and evaluating the consequence of a specific tax.

⁶³ Vivian, 79.

⁶⁴ Mclean. 34.

⁶⁵ Margo Commission, "Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa," (1986), 50.

⁶⁶ Utz. 867.

⁶⁷ R.B. Goode, *The Individual Income Tax* (Brookings Institution, 1976), 11.

⁶⁸ Smith and McCulloch, 825.

3.2. Meaning and origin of the proportionality principle

3.2.1. From the perspective of Adam Smith's first maxim

Smith's first maxim can be equally construed as a principle of proportionality. Not only does this mean that the tax levied on an individual should be proportional to that individual's income and ability to be able to afford to pay the tax, but also that the content and form of the tax should not go beyond what is required to attain a legitimate purpose.

Proportionality has been described as a legal principle, meaning, in plain English:

*"You must not use a steam hammer to crack a nut, if a nutcracker would do."*⁶⁹

In essence, this suggests that the means one employs to achieve a certain end, must be proportional to that end.⁷⁰

A country is free to levy tax within its territorial jurisdiction. This principle is commonly known as the *fiscal territoriality principle*. Essentially it implies that no taxes can be levied outside the territorial jurisdiction without violating the sovereign tax authority of another state. Fiscal territoriality, however, offers no guidance on *how much* income should be taxed and *when* taxation may or should take place. This issue is dealt with in the light of the Ability-to-pay principle and the principle of proportionality. It is therefore essential to understand the rationale, motivation and boundaries of exit tax, especially since commentators view effective realisation of income as a cornerstone of the Ability-to-pay principle.⁷¹

3.2.2. As a general principle in the EU

The proportionality principle is one of the fundamental principles of the EU:

"In the context of EU law, an infringement of the principle of equal treatment through discrimination or the imposition of a restriction is prohibited unless there is a justification for the infringement. Such a justification must be proportionate,

⁶⁹ *R v Goldstein*, 151,55.

⁷⁰ *Ibid.*

⁷¹ Braga, A.P., "The Corporate Exit Taxes and the Eu. A Special Reference to the Portuguese Regime" (School of Advanced Study University of London, 2011), 4.

meaning that the measure must be appropriate to the objective in question and must not go beyond what is necessary to achieve that objective (article 5 of the Treaty on European Union). In considering whether or not a measure is proportionate, consideration must be given to whether or not less restrictive means of achieving the objective are available.”⁷²

The above principle is found in paragraph 4 of Article 5 of the Treaty on the European Union (“TEU”) which requires that “*the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.*” The criteria for applying the proportionality principle is set out in the Protocol (No. 2) on the application of the principles of subsidiary and proportionality annexed to the TEU.

Proportionality is therefore also a legal principle in the EU that allows (or requires) balancing between competing values. This principle therefore services as a legal mechanism to decide whether a measure has gone beyond what is required to attain a legitimate purpose.

3.2.3. Proportionality in the international and South African legal framework

Academics have described the proportionality principle as an element of a globalised, common constitutional grammar and of central importance in modern public law.⁷³

The first codified version of proportionality came to light in Article 10(2) in the German public law, which reads:

“The police is to take the necessary measures for the maintenance of public peace, security and order.”⁷⁴

In terms of this public rule, it was understood that the police must exercise discretion in combatting disorder. The courts, however, turned it into a rule that limits the exercise of discretion meaning that the police were only entitled to use such means that were necessary and appropriate to combat disorder.⁷⁵

⁷² IBFD’s International Tax Glossary.

⁷³ Rautenbach, 2.

⁷⁴ Article 10(2) of Allgemeines Landrecht für die Preussischen Staaten of 1794 – referred to in Rautenbach, 2.

⁷⁵ Rautenbach, 2.

The ordinary meaning of the term “proportionality” is “*in due proportion, corresponding in degree or amount*”. “Proportion” means a “*due relation of the one thing to another or between parts of a thing*.”⁷⁶

The elements that came out of German law is that the “*parts of things*” concerned are the limitation of the right on the one hand and the purpose of the limitation on the other.⁷⁷ This can also be described as the “*harm imposed*” versus “*the benefit achieved*”. This gives one the idea that the parts must be weighed and/or balanced.

The dictionary meaning indicates that a “*due*” relation between the limitation and its purpose would render the limitation justifiable. It therefore appears that a limitation cannot be justified if no purpose exists. It is said that the principle of proportionality involves more than just providing reasons for a decision or action.⁷⁸ In general terms, the reasons given must be “*plausible*” or “*proper*” reasons which make one to think that proportionality also has a substantive meaning and that good cause must exist.⁷⁹

In a Constitutional context, Rautenbach describes the different “*stages*” to the proportionality principle or test as follows:⁸⁰

- i. whether the act pursues a legitimate aim;
- ii. suitability, whether the act is capable of achieving this aim;
- iii. necessity, whether the act impairs the right as little as possible; and
- iv. the balancing stage - whether the act represents a net gain, when the reduction on enjoyment of rights is weighted against the level of realisation of the aim.

In its most basic form, these rules simply mean that the limitation is capable of contributing “*something*” towards achieving the goal.⁸¹ Rautenbach warns that one should, however, be careful not to oversimplify these rules.

⁷⁶McIntosh Fowler and Fowler Concise Oxford Dictionary, 963.

⁷⁷ Rautenbach, 2.

⁷⁸ Ibid., 3.

⁷⁹ Ibid.

⁸⁰ M. Klatt and M. Mesiter, *The Constitutional Structure of Proportionality* (Oxford University Press, 2012), 8.

⁸¹ Rautenbach, 3.

A constitution generally contains provisions that apply to the limitation of specific rights or general limitation clauses that apply to all rights – such as section 36 of the South African Constitution.

Even though section 36, the general limitation clause, in the South African Constitution does not expressly refer to proportionality, it is submitted that elements of the proportionality principle are taken into account in this provision when determining whether a violation is justifiable.

In the first reported judgement of the South African Constitutional Court, *S v Zuma*,⁸² the Court considered some generally recognised elements of the proportionality principle in determining the balance between the limitation of rights and the purpose of such limitation. The Court confirmed that the proportionality principle is a useful instrument to give effect to concepts such as “reasonable” and “necessary”.

In *S v Makwanyane*⁸³, the Constitutional Court held the following:

“The limitation of constitutional rights for a purpose that is reasonable and necessary in a democratic society involves the weighing up of competing values, and ultimately an assessment based on proportionality”.

The Court therefore confirmed that the proportionality principle is a useful instrument to give effect to concepts such as “reasonable” and “necessary”.⁸⁴

Elements of proportionality are also taken into account in applying the “reasonableness” requirement in terms of the Canadian and Indian Constitutions. Proportionality must always be taken into account with regard to limitation of certain rights in the European Convention on Human Rights.⁸⁵

The fact that the approach in the different countries’ courts with regard to proportionality is not identical, is evidence that there is no absolute standard which can

⁸² *S v Zuma*, BCLR 401 (1995).

⁸³ *S v Makwanyane*, SA 391 (1995).

⁸⁴ Rautenbach, 89.

⁸⁵ *Ibid.*

be laid down for determining whether a limitation is reasonable, necessary or achieving a legitimate purpose.⁸⁶

Certain standard principles or considerations can certainly be identified as principles that must be taken into account when applying the proportionality test. One such principle mentioned by Rautenbach is, where the limitation is necessary, whether the desired ends could not reasonably be achieved through other means less damaging to the right in question.⁸⁷ If the answer is positive, the route or means with the less damaging effect must be taken.

South African case law is evidence that South African courts apply elements of proportionality when it interprets the particular words and phrases found in the South African Constitution. Accordingly, it is submitted that proportionality is a prominent feature of the application of the limitation clauses in the South African Constitution. South Africa therefore participates fully in the global recognition and application of this principle.

3.3. Exit tax from a principled perspective

The main criticism against exit tax is the fact that it is rigidly imposed when a deemed disposal takes place, i.e. no disposal actually takes place and accordingly no revenue is realised. At first sight, this leaves much room for uncertainty regarding the Ability-to-pay principle as the taxpayer may not be solvent in order to pay the tax. Even if he is solvent, he is put in a disadvantageous financial position compared to a person who chooses to stay in the country with the same unrealised gains as well as to a person who actually disposes of similar assets.⁸⁸ Hence, a differentiation of two categories of taxpayers having certain assets.

If a deferral method is adopted by which the exit tax is only collected upon the actual disposal of the asset, this observation will lose its actuality, because the exit tax will only be levied once the asset is actually sold and monies are received.

⁸⁶ Rautenbach, 3.

⁸⁷ Ibid., 4.

⁸⁸ Braga, 7.

Some commentators argue that, from a benefit standpoint, countries that impose exit tax may claim that, since they provided the migrant the same benefits available to a non-migrant, they have a right to a payback in the form of a tax similar to that which would have been charged in the case of disposal of the relevant assets.⁸⁹

Exit tax may possibly be justified when taking into account that similar treatment is given to taxpayers who benefit from similar conditions provided by the emigration country (while the taxpayer was a resident of the emigration country):

"If it is a sound principle to require taxpayers to meet their income tax obligations when leaving a country, it is no less fair in principle to tax capital gains enjoyed while the taxpayer has shared the rights and responsibilities of residence..."⁹⁰

If this argument is to be true, it is said that there would need to be a direct link between the tax on underlying gains and any deductions or allowances provided by the emigration country.

This view is supported by Dyer and Yager:

- "i) Any tax deduction or use of public goods may have been compensated by taxes paid at origin within the life of a company [or individual] prior to migrating; i.e., benefits and taxation may be temporally matched. A sign of such compensation may be the inexistence of carry-forward losses at the time of migrating;*
- ii) It is likely that the bulk of the potential gains on exit derive from discounted cash-flow valuations, relating to cash-flows not only future, but also expected to be sourced outside the origin state."⁹¹*

Holmes advanced a more simpler argument by providing three reasons why unrealized capital gains (pure potential gains) should not be included as taxable income.⁹²

⁸⁹ Braga, 7.

⁹⁰ G.J.R. Dyer and J. Yager, "Canada" In: *International Fiscal Association, 2002 Oslo Congress, Cahiers De Troit Fiscal International, "the Tax Treatment of Transfer of Residence by Individuals"* (New York: Kluwer Law International, 1992), 193.

⁹¹ Braga, 42.

⁹² Holmes, 381.

- i. It is administratively impractical to value a wide range of property on an annual basis. It is also unlikely that such valuations are sufficiently accurate as elements in a measure of income. In the light of exit tax, even though such a valuation will only take place upon emigration, the valuation may very well be a complex and expensive exercise depending on the assets which is owned by the emigrating taxpayer. This is particularly relevant for foreign share interests.
- ii. It is unfair to include unrealized gains in income for tax purposes and require a person to pay tax in money on gains that have not yet been converted into cash, since those gains may not be converted into cash even in the owner's lifetime. This statement addresses the main issue regarding exit taxes in that a taxpayer is required to pay money (tax) on an unrealized gain as a result of a deemed disposal.
- iii. The third reason is an extension of the second. If a taxpayer is required to pay money even though no money was received for the asset (since there was no transaction), it might force the liquidation of the subject assets (or some of them) to finance the payment of the tax liability. If the result of an exit tax is to force the sale of the underlying assets, the tax system is not neutral.

Considering this in the light of the Ability-to-pay principle, accrued unrealised gains or "wealth" essentially provides security, independence and the ability to consume. Accrued unrealised gains therefore likely confers an ability to pay over and above the income that is generated by it.

Before capital was taxed in South Africa, it was said in the Margo Commission report that capital as such contributes to a person's ability to pay taxes, and consequently offers a further potential base for levying tax.⁹³ This capital therefore contributes to the taxpayer's ability to pay.

More than likely, it is the high net worth individual who can easily move or relocate their assets to a more tax-friendly jurisdiction. Not taxing the accrued or unrealised gains of such assets will leave a significant income untaxed.

⁹³ Margo commission report, 311.

Exit tax is intended to tax accrued unrealised gains or wealth and, should such accrued gains not be taxed, it may lead to international double non-taxation and loss of revenue for the emigration country.

At this stage a conclusion can be drawn that, although counter arguments may exist, exit tax may arguably be justified as a way to give similar treatment to taxpayers who benefited from similar conditions provided by the emigration country.⁹⁴ In addition, accrued gains contribute to a person's wealth and ability to consume and, in turn, to a person's ability to pay. It would therefore make sense to tax accrued gains in accordance with the Ability-to-pay principle.

The EU views such a restriction as a restriction of the principles of equal treatment. Countries across Europe have been forced to reform their exit tax provisions in order to suppress this restriction.

3.4. Are exit tax provisions of South Africa proportional to the purpose of such taxes?

In order to determine whether an exit tax regime is proportional to the purpose of exit tax, a distinction should be drawn between the establishment of the amount of exit tax and the recovery of exit tax.⁹⁵ This suggests that not only should the amount of tax levied be proportional to the purpose of exit tax, but also the manner in which it is recovered.

Given the various forms of exit taxes and the various circumstances in which they are applicable, it is acknowledged by the author of this paper that, strictly speaking, it is necessary to consider each tax on an incremental basis. For this reason, the following sections seeks to evaluate and discuss in a general manner the issues which arise with regard to exit tax provisions in general and the different measures implemented by other countries to establish the amount and collection of exit tax.

⁹⁴ Braga, 5.

⁹⁵ *Case (C-371/10) National Grid Indus Bv v Inspecteur Van De Belastingdienst Rijnmond/Kantoor Rotterdam*, (2011).

3.4.1. EU jurisprudence on the migration of individuals

Exit tax is part of the tax system of many EU countries and has been considered in a number of European court cases where the ECJ found that exit taxes may not be levied in an unrestricted manner, specifically referring to the cash flow disadvantage as a result of an immediate exit tax.⁹⁶ In order to prevent the cash flow problems that exit tax may cause (which ultimately results in an infringement on the “freedom principles”), many EU Member States (hereafter referred to as ‘Member States’) adopted alternative methods to levy and collect exit tax, one of which being a deferral method. In terms of a deferral method a migrant will only pay exit tax upon the actual disposal of the relevant assets.

Direct taxation falls within the competence of Member States as Member States are free to establish the criteria for taxation of income and wealth within their sovereign territory, i.e. what types of taxes to levy, the rate at which taxes are levied, the tax object and subject. At the same time, however, according to the ECJ, the powers retained by the Member States, must conform to EC Law.

The EC essentially has the function of ensuring the correct application and interpretation of the EC Law. Well-established case law in the EU has determined that EC Law takes precedence over national law, including international agreements concluded by Member States.⁹⁷ Due to the lack of positive harmonisation between Member States with respect to direct taxes, the ECJ plays a key role in establishing a balance between Member States’ interests, Union principles and taxpayers' rights.

The TFEU is one of the main treaties of the EU, alongside the TEU. The TFEU forms the detailed basis of the EU law and sets out the scope of the EU’s authority to legislate in areas where the EU law is applicable.

In the EU, the principles of a single market is established through Article 26 of the TFEU which states that the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital are free to circulate.⁹⁸ Articles 39 and 56 of the TFEU provide for the free movement of workers,

⁹⁶ Maisto, 41.

⁹⁷ De Broe, 79.

⁹⁸ Ibid., 83.

freedom of establishment, freedom to provide services and free movement of capital. The free movement of persons is impacted by the two aspects of free movement of workers and free movement of establishment which are fundamental to the TFEU and the EU single market. Article 49 of the TFEU further prohibits restrictions on the freedom of establishment.

According to commentators, the wide scope of the free movement provisions undermines the tax sovereignty of Member States.⁹⁹ This results in conflict between the tax sovereignty of the Member states and the freedoms provided by the TFEU. Exit tax provisions of Member States is one example which result in such a conflict.¹⁰⁰

It is generally accepted that the levying of exit tax in the EU can give rise to several issues for the taxpayer, which includes:¹⁰¹

- i. double taxation in the event of no step-up (increase) in the base cost of the assets in the immigration country (which is mainly caused by the lack of global EU harmonisation of exit tax);
- ii. a cash-flow disadvantage for the taxpayer since exit tax generally arises at the date of emigration; and
- iii. if no consideration is given to future fluctuations in asset valuations after migration and there is an increase or decrease in the value of the asset between the date of emigration and actual realisation of the asset, the emigration country and the immigration country may either tax more or less than they would ordinarily have done in the case of an actual realised gain.

Despite these issues, the ECJ has made it clear that an exit tax can be justified by the balance of allocation of taxing powers between Member States.¹⁰²

⁹⁹ S.C.W. Douma, *Severe Criticism on the Ecj in Direct Tax Matters in Optimization of Tax Sovereignty and Free Movement*, (IBFD Online Books).

¹⁰⁰ In the EU, some authors are of the view that exit tax can also assume a form of extended tax liability which essentially means that an individual is subject to tax for a certain period after emigration. Consequently, it is reasonable to assume that there are two different kinds of exit taxes i.e. general exit taxes and extended tax liability. This is discussed in more detail in chapter four. See also De Broe, 80.

¹⁰¹ S. Wallace and S. Murphy, "Exit Taxes: Where to Now? After Ecj Decision in *National Grid Indus Bv*," no. 2012 Number 2, <https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/2012_exit_taxes_deloitte_ireland.pdf>.

¹⁰² *Case (C-470/04) N v Inspecteur*, ECR I-7409 (2006).para 42.

So what exactly is the problem with exit tax then? Case law indicates that as far as the exercise of the power of taxation so allocated is concerned, Member States may nevertheless not disregard Community Rules.¹⁰³

In *Commissioner v Spain*,¹⁰⁴ the law of Spain, at that time, created an obligation for an individual taxpayer to immediately pay exit tax on all income which had not yet been realised by including it in the tax base corresponding to the last tax period. The Spanish legislation at that time provided only for taxation of income which the revenue authority had record of and which had already been realised.

The ECJ held that an exit tax on realised income cannot be justified by the balanced allocation of taxing powers because the income was already taxed in the country in which it was realised. In addition, the income that was to be obtained in the immigration country (after the transfer of residence) will be taxed in the immigration country.

The ECJ also concluded that an immediate recovery of exit tax upon emigration is not proportional to the purpose of exit tax. Not surprisingly, the motivation for the judgement was based on the fact that the Spanish exit tax provisions result in a cash-flow disadvantage for the taxpayer. The ECJ further held that the immediate recovery method resulted in a difference in tax treatment of a person emigrating when comparing that person with a person who maintains his residence, since the taxpayer who maintains his residence will only pay tax on accrued gains when his assets are actually disposed of.

Even though this case does not deal with “traditional” exit tax, it underlines the fact that the ECJ does not allow immediate recovery of exit tax debt at the time of the transfer of residence.

In another case, *N v Inspecteur*,¹⁰⁵ a Dutch resident, N, transferred his residence to the UK, along with a shareholding in three limited liability Dutch companies. In the year of migrating, N submitted a return declaring taxable income from his own dwelling and the profit from his shareholding. At his request, N obtained a deferment of those

¹⁰³ Case (C-307/97) *Saint-Gobain*, [1999], ECR I-6161, para 57

¹⁰⁴ Case C-269/09 *Commissioner v Spain*, (2012).

¹⁰⁵ Case (C-470/04) *N v Inspecteur*.

payments, however, according to national legislation in force at that time, such a deferment was subject to the provision of security. As a result, N deposited his holdings in one of his companies as security.

The ECJ confirmed that the exit tax provisions resulted in a restriction on the freedom of establishment. The ECJ went on to assess whether the restriction could be justified. In this case, the ECJ concluded that the exit tax was in fact a question of exercise of the Netherland's power and that it was free to determine local taxation of the gains accrued during residence therein.¹⁰⁶

The outcome of the aforementioned case justified exit tax by making use of the principle of fiscal territoriality. This is in stark contrast to the outcome of *Commissioner v Spain*.

The ECJ, however, held that the obligation to provide collateral security is not proportional to the purpose of preserving taxing powers on the basis that EU Member States can make use of the Mutual Assistance Directives in order to recover claims that result from exit tax.¹⁰⁷ The ECJ concluded that a less burdensome measure is available such as filing a tax declaration at the time of exit.

The most distinct part of the judgement was the ECJ's suggestion that exit tax systems must take into full account the reductions in value of the relevant assets after transfer of residence by the taxpayer unless such reductions have already been taken into account in the immigration country.¹⁰⁸

A similar judgement followed in the *De Lasteyrie* case,¹⁰⁹ where an individual who transferred his residence from France to Belgium, was granted the option to defer the payment of exit tax on condition that he had to appoint a fiscal representative, file a tax declaration and provide sufficient guarantees to ensure that the revenue authority could recover any tax due upon departure. The case was referred to the ECJ on the basis of incompatibility with the freedom of establishment.

The ECJ held that, although exit could be justified by the balanced allocation of taxing powers between Member States and by the principle of territoriality, the fact that the

¹⁰⁶ See para 41.

¹⁰⁷ See para 38 and 49.

¹⁰⁸ *Case (C-470/04) N v Inspecteur*, para 54.

¹⁰⁹ *Case (C-9/02) De Lasteyrie Du Saillant*, (2004).

deferral was granted was irrelevant since it was granted upon various conditions which were not present in internal migrations. Mr. De Lasteyrie was therefore treated less favourable than an individual who maintained his or her residence in the emigration country. The ECJ found that the obligation by the taxpayer to submit a return was proportional to the purpose of the exit tax.¹¹⁰

In this case, France tried to justify the exit tax on the basis that it was aimed at preventing tax avoidance – which the ECJ dismissed on the basis that the French exit tax was not designed to counteract harmful or abusive practices.¹¹¹

Even though there are ambiguities and conflicting ECJ judgments, one can conclude that exit tax is compliant with EU law only if:

- i. it is in the form of a tax assessment at the moment of the exit and if there is an automatic deferral of tax; and
- ii. the amount of exit tax collected upon the actual disposal takes into account any increase or decrease in the asset value subsequent to emigration.

3.4.2. The proportionality test in a South African context

As explained in the previous section, applying the proportionality test to exit tax in the EU, the “*parts of the thing*” would be the right to freedom of establishment (as enshrined in Article 49 of the TFEU) in the one hand and then the benefit or purpose of exit tax in the other.

The TFEU is not applicable in South Africa - South African individuals’ right to freedom of movement is protected in the South African Constitution.¹¹² Due to a lack of South African jurisprudence concerning this topic, it is commonly accepted that exit tax does not result in an infringement of this right.

Although the analysis in the previous section is done in the European context, it recognizes that an immediate recovery of exit tax creates a restriction for the taxpayer.

¹¹⁰ Para 38, 49.

¹¹¹ In Case (C-196/04) *Cadbury Schweppes*, [2006] ECR I-7995, it was held that exit tax must be directed at purely artificial arrangements in order for the provision to be justified by this reason - see para 54.

¹¹² Section 21 of the Constitution of South Africa.

This restriction is not only recognised by EU-countries, but also non-EU countries such as Canada.

Exit tax was introduced in Canada as part of the introduction of CGT in 1972 with the purpose to *“eliminate the possibility for a taxpayer to escape tax on property gains that accrued during Canadian residence by becoming non-resident.”*¹¹³

Like South African exit tax provisions, Canadian exit tax provisions provide that a deemed disposal of each property which the emigrating individual owned at the time of departure, takes place immediately before terminating residence.¹¹⁴

Even before the introduction of exit tax provisions in Canada, it was argued that such provisions will deter the mobility of Canadians.¹¹⁵ To prevent this issue the first exit tax legislation adopted in 1972 already offered the taxpayer a choice to defer payment of exit tax.¹¹⁶ Upon departure, the individual may pay tax on his accrued gain with an exemption for the first 5,000 dollars. A deferral of exit tax is allowed upon the condition that the individual will file a tax return in the year in which he sells the relevant assets. The individual is also required to provide reasonable security at the time of departure to cover the debt. If security is posted, the assets covered by the security will become taxable Canadian property and will be subject to tax on capital gains in Canada accruing after the date of departure.¹¹⁷

In applying the proportionality test to South African exit tax provisions, the first question would be whether exit taxes restrict and impede the mobility of a taxpayer. EU jurisprudence and international precedent shows that the answer to this is “yes”. The fact that a taxpayer may be forced to sell a portion or all of his assets in order to pay his exit tax debt clearly impedes his mobility – irrespective of whether the taxpayer has a right to freedom of movement which is violated.

¹¹³ Dyer and Yager, 193.

¹¹⁴ Ibid.

¹¹⁵ E.J. Benson, Minister of Finance, The Summary of the 1971 Tax Reform Legislation, "Raspberry Book", available at <http://publications.gc.ca/collections/collection_2016/fin/F2-241-1971-eng.pdf>. 34.

¹¹⁶ Ibid.

¹¹⁷ J. Rogers - Glabush, Canada - Individual Taxation (Section 6), (Available on the IBFD Website). 34.

As mentioned already, in applying the proportionality test to exit tax, a distinction should be drawn between the establishment of the amount of exit tax and the recovery of exit tax.¹¹⁸

In establishing the amount, it should be taken into account that Income Tax Act provides numerous exemptions to CGT which may in fact minimise or eliminate the negative cash flow implications upon emigration.

Apart from Section 9H of the Income Tax Act which provides that exit tax will not apply in respect of immovable property situated in South Africa, the Eighth Schedule also provides that some disposals are fully exempt from CGT. These exemptions apply equally to deemed disposals as referred to in section 9H when an individual emigrates to another country.

The Eighth Schedule provides that certain capital gains and losses on the disposal of specified assets are excluded from CGT:¹¹⁹

- Personal-use assets, which generally include personal belongings such as a motor vehicle, artwork, a caravan, furniture, household appliances and other assets used mainly (i.e., more than 50%) for a non-trade purpose;
- Boats not exceeding ten metres in length and aircrafts having an empty mass of 450 kilograms or less which are personal-use assets;
- Lump sum payments from pension, pension preservation, provident, provident preservation and retirement annuity funds (approved retirement funds); and
- Disposal of an interest of at least 10% in a foreign company.

The Eighth Schedule also provides an annual exclusion of R40,000 for natural persons.¹²⁰ An exclusion limited to R2 million is also available for an individual's primary residence,¹²¹ however, this is not relevant in the light of exit tax as exit tax does not apply to assets which remain in the country, i.e. immovable property.

Even though a major portion of a taxpayer's assets may not be subject to exit tax upon emigration, it is particularly the financial assets and business assets which will create a

¹¹⁸ *National Grid Indus C-371/10*, para 86.

¹¹⁹ See para 52 to 64 of the Eighth Schedule.

¹²⁰ See para 5 of the Eighth Schedule.

¹²¹ See para 44 – 50 of the Eighth Schedule.

problem. Establishing the amount of exit tax on such assets may be proportional, but requiring immediate payment of this tax upon departure may very well still create a restriction which may impact the taxpayer's decision to emigrate to a foreign jurisdiction. The impact that the immediate recovery method has on taxpayers as opposed to revenue authorities seems disproportionate.

It is therefore worth asking whether the immediate recovery method serves a specific purpose and, as mentioned by Rautenbach whether the purpose can be achieved through other means less damaging.

As mentioned in chapter two, the only logical reason for applying this method to collect exit tax would be to eliminate the SARS' administrative difficulties in tracking the assets of a former resident. With the current focus, both internationally and in South Africa, on increasing taxpayer information transparency and exchange of information, it is worth asking whether this can be viewed as a "*plausible reason*" for applying an immediate recovery method.

Many authors have tried to apply the proportionality test to exit tax. De Broe is of the view that an "*all facts and circumstances*" test should be undertaken in evaluating the proportionality of exit tax provisions whereby the following specific questions must be considered:¹²²

- " – Does the emigration country give appropriate relief via reverse credit (such as under the Dutch, French and Danish exit tax)?¹²³*
- Do its DTCs [DTAs] provide that the immigration country shall give such relief by way of a step-up or credit (for exit tax: certain Danish and German DTCs)?*
- Does the emigration country allow a postponement of payment of the exit tax until actual realization of the asset (Denmark and Australia)?*
- Does it provide for an offsetting of accrued losses against accrued gains on emigration?*
- Does it take into account a decrease in value after emigration (Denmark, France and the Netherlands)?*

¹²² De Broe, 77.

¹²³ This is discussed in more detail in chapter four.

- *Is the exit tax system symmetric via a step-up in basis for immigrants (Austria, Denmark and, conditionally, the Netherlands.)*

For the majority of these questions, the answer is “no”. Even though South Africa does provide for a step-up in the tax base, the immigration country has no legal obligation to accept the stepped-up value as the new tax base. It should also be mentioned, apart for providing a step-up in the tax base of the asset, South Africa does not provide unilateral relief for foreign taxes paid.

Other countries have in fact proven that there are alternative methods in collecting exit tax which is less burdensome for the taxpayer. These methods are discussed in more detail in the following chapter and have been justified on the basis that they are proportional to the purpose of exit tax.

The limitation in respect of the immediate recovery method (especially the negative cash flow pursuant to an immediate exit tax) is therefore not necessary.

3.5. Summary remarks

There is indeed a rational for taxing unrealised gains on assets not disposed of by a resident upon emigration, however, exit tax seems to act as a penalty for the taxpayer when he decides to relocate to a foreign jurisdiction.

Exit tax is justified in the EU on the basis of territoriality and the balanced allocation of taxing powers between Member States. The ECJ has, however, repeatedly held that a method whereby exit tax is collected immediately upon emigration cannot be justified.

The ECJ established that it is proportional to establish the amount of tax at the time of exit, but disproportional to recover the tax at the time of exit because of the cash flow disadvantage pursuant to this method.¹²⁴ Other non-EU countries also view the cash flow disadvantage as a restriction on a taxpayer’s mobility and have implemented alternative measures to levy and collect exit tax.

In the light of the conclusions reached in this chapter, it is submitted that the current manner in which the SARS levy and collect exit tax, is not proportional to the purpose of

¹²⁴ *Case (C-371/10) National Grid Indus Bv v Inspecteur Van De Belastingdienst Rijnmond/Kantoor Rotterdam*, para 86.

exit tax. International precedent shows that the significance of the cash flow burden pursuant to an immediate exit tax cannot be ignored and countries, including South Africa, should consider adopting less restrictive measures to collect and levy exit tax.

CHAPTER 4: ALTERNATIVE MEASURES TO LEVY AND/OR COLLECT EXIT TAX

4.1. Alternative exit tax methods used by EU Member States

In summary, the following three methods are implemented in the EU to levy and collect exit tax:¹²⁵

- i) exit tax is charged and collected upon departure;
- ii) a preserving assessment is issued for a certain time period; and
- iii) the exit tax is deferred until the actual realisation of the gain.

As indicated in the previous chapter, EU case law has established that the first type of exit tax above may not pass the proportionality test. Considering the second type of exit tax, providing a preserving assessment usually requires the taxpayer to provide security at a time when that individual has not yet realised income from the assets that are subject to exit tax. This may be costly and therefore restrict free mobility. Accordingly, this method may also not pass the proportionality test (although this needs to be evaluated on a case-by-case basis). With regard to the third type of exit tax, the previous chapter concluded that the ECJ accepts only an exit tax which provides the taxpayer with the choice to defer the tax liability or, at the least, do not require immediate payment of the exit tax.

Member States which do not have a comprehensive CGT regime, applies an extended exit tax liability method. An extended exit tax liability means that the emigration country retains the right to tax a former resident upon the actual realisation of the asset.¹²⁶

Importantly, exit taxes serve different purposes which may differ according to the circumstances in which they are imposed. Accordingly, this chapter discuss the different methods to levy and collect exit tax in general.

Countries, including Germany, Denmark, Austria, the Netherlands and France, apply an extended exit tax liability mainly with respect to shareholding for the reason that *"...those countries have relinquished their taxing rights on capital gains on shareholding to the country of residence of the shareholder either under domestic law (Denmark, for all*

¹²⁵ De Broe, 77.

¹²⁶ Ibid., 29.

shares regardless of whether in Danish or non-Danish corporations; the other countries, for shares in non-resident companies) or under their DTCs.”¹²⁷

An extended exit tax liability is implemented (on share gains) by the emigration country by way of a provision in its DTAs which gives it the right to tax gains realised by former residents for a number of years after emigration.¹²⁸ This is done by issuing a preserving assessment to the taxpayer while he is still a resident. If the shares are not realised within the specified period after emigration, exit tax becomes payable on the gain accrued while the taxpayer was a resident.

Evidently, countries which make use of this method to levy and collect exit tax also realised that the taxpayer may suffer a negative cash flow upon emigration if they require immediate payment. Different measures are therefore implemented to provide the taxpayer with relief.

In Germany, the payment of exit tax may be spread over five years if the taxpayer relocates to a non-EC country.¹²⁹ If the taxpayer relocates within the EC, he will have the option to defer the payment of exit tax until actual realisation of the shares.¹³⁰ Moreover, the taxpayer may recover the exit tax liability from the German Revenue Authority if he reacquires residence in Germany within five years of relocating.¹³¹ Interest is charged on the outstanding balance of the tax liability and security must be provided.¹³²

Denmark also allows an exit tax liability to be deferred (with interest) until actual realisation of shares provided that the shares qualify as security.¹³³

The Netherlands provides an alternative method by issuing a preserving assessment for a 10 year period (without interest). The preserving assessment becomes due if the shares are sold within the 10 years and is waived after 10 years if the shares are not

¹²⁷ Ibid., 37.

¹²⁸ The rationale behind this is to prevent tax-motivated emigration.

¹²⁹ Ibid., 39.

¹³⁰ Ibid.

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid., 39.

sold.¹³⁴ France follows a similar method, but the preserving assessment is imposed for only five years.¹³⁵

Generally, a country will not have the right to tax gains realised by a former resident on shares in a company which is a non-resident of the emigration country (Article 13(4) of the OECD Model). For this reason, Germany and France restrict the application of their exit tax to German / French companies.

With regard to the increase or decrease in the value of the shares after emigration, Denmark allows the deemed capital gain to be reduced (calculated at the time of emigration), if the shares are later sold at a lower price. A credit is subsequently given for the foreign tax levied on the same capital gain.¹³⁶

An alternative solution offered by some countries (the immigration country) is to provide a foreign tax credit for the taxes of the emigration country. Many countries have, however, indicated that they do not provide a credit under their domestic law because of the time lag between the two taxable events and because exit tax was levied while the individual was a non-resident.¹³⁷ Generally, an individual will qualify for a foreign tax credit only while he is a resident and the foreign tax and domestic tax have become due in the same year of assessment.

The UK is an exception to this rule. The UK follows the principle that the foreign tax is computed by reference to the same gain that is chargeable with the UK tax.¹³⁸ There is no requirement that the asset must be disposed of in the year that the gain is realised nor is there a requirement that the realisation must occur within a fixed time period after emigration.¹³⁹

It can also be argued that this method is possible in countries which issue a preserving assessment since the preserving assessment will only be collected upon actual realisation of the asset. Accordingly, the taxable events will effectively occur at the same time (and within the same year).

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ Ibid.

¹³⁷ Ibid., 60.

¹³⁸ Ibid., 61.

¹³⁹ Ibid.

An exit tax liability can also be relieved if the emigration country, on the other hand, allows a foreign tax credit for taxes of the immigration country (i.e. a reverse credit). Canada have specific domestic rules that allow for a foreign tax credit against its general exit tax. Notably the credit will be allowed only if Canada have a signed DTA with the immigration country.¹⁴⁰ There is also no time limit imposed on claiming the credit.¹⁴¹

Other countries such as Denmark and the Netherlands provide for a reverse credit where a limited exit tax was levied on shareholdings.¹⁴² The credit is limited to the tax imposed by the immigration country only on that part of the gain that was subject to exit tax.¹⁴³

Regarding interest on a deferment of payment of exit tax, EU case law indicates that it is proportional to provide the taxpayer with a choice to defer exit tax, together with interest in accordance to the emigrating country's domestic legislation.¹⁴⁴

Interest is usually paid by a borrower to a lender for the risk of non-recovery (credit risk). The exit tax is essentially deferred in order to alleviate the taxpayer from the cash flow burden caused by the exit tax. Levying interest will defeat the point of the deferral of tax and may even contribute to the cash flow disadvantage.

If levying interest does not affect the amount of tax to be established or assessed, it will be hard to determine the necessity of interest. A deferral of tax will always involve a risk of non-recovery and should depend on the taxpayer's creditworthiness and guarantees. If interest is to be levied, it must first include an assessment of the risk of non-recovery.

Including the opportunity cost for the Member State could result in a case in which it is as if the exit tax have been paid immediately thereby effectively neutralising the benefit of deferral.¹⁴⁵ Furthermore, considering the time value of money with respect to the age of the claim, some countries have placed a limit on the time period of the deferral.

Countries such Denmark, the Netherlands, France and Portugal provide a time limited

¹⁴⁰ The foreign tax credit was designed as an interim measure pending the renegotiation of Canada's DTAs in order to provide for the immigration country to allow a step-up in the basis – See De Broe, 63.

¹⁴¹ De Broe, 63.

¹⁴² Ibid.

¹⁴³ Ibid.

¹⁴⁴ *Case (C-371/10) National Grid Indus Bv v Inspecteur Van De Belastingdienst Rijnmond/Kantoor Rotterdam*, para 73.

¹⁴⁵ M. Tell, "Exit Taxation within Teh European Union/European Economic Area - after *Commission V. Denmark* " 54 (2014).

length of deferral and/or annual instalments.¹⁴⁶ The ECJ has, however, not previously provided guidance in respect of the length of the deferral.

4.2. Alternative exit tax methods used by other countries

Vogel is of the view that ultimately two regulatory models exist in today's tax systems by which the emigration country secures the taxation of hidden reserves that have accumulated until the change of residency:¹⁴⁷

- "i) the exit State establishes the taxes on the not-yet-realized hidden reserves independent from the alienation before the change of residency; or*
- ii) the exit State retains the conditional or temporary right to tax part of the hidden reserves at the point of the actual alienation."*

According to Vogel, the first model is generally combined with a deferment of the exit tax until the point of actual realisation of the reserves, i.e. when the asset is actually sold, whereas the second model grants the emigration country with extended rights to tax accrued gains upon actual realization.¹⁴⁸ In terms of the first model, an assessment is made immediately upon emigration while the taxpayer is still a resident.

Since exit tax is also used *"as a way to extend a state's ability to tax after the change of tax residence status"*,¹⁴⁹ it can be argued that there are broadly two types of exit taxes: immediate exit taxes and capital gains taxes on former residents (i.e., an extended tax liability).¹⁵⁰

The traditional view in respect of an immediate exit tax method is that a change in residency falls within the scope of the term *"alienation"* in terms of the OECD Model Convention and, accordingly, the taxation of unrealised gains as a result of a change in residency should be treated as a capital gain in terms of Article 13 of the OECD Model. Not all countries share this view. Numerous contrasting arguments exist that Article 13 of the OECD Model is not the appropriate distributive rule to deal with exit tax on the

¹⁴⁶ De Broe, 76.

¹⁴⁷ Vogel, 1081.

¹⁴⁸ Ibid.

¹⁴⁹ Carramaschi, 2.

¹⁵⁰ Ibid.

basis that unrealised gains should not be subject to tax and there has to be an actual realisation before gains can be subject to taxation under Article 13.¹⁵¹

An exit tax will likely only produce its desired effect if it does not violate its DTA obligations and is compatible with the provisions of the DTA.

Extended exit tax liabilities are generally levied on the effective and realised gains stemming from the alienation of properties carried out by a *former resident* taxpayer at some point in time after emigration.¹⁵² The issue is that two countries simultaneously will claim the status of “*state of residence*”. Countries that want to follow this model therefore have to include special clauses in their DTAs if they want to include capital gains in their domestic tax base which a taxpayer only derived as a non-resident (after the individual moved away).

As a result, some countries choose to reserve their right to tax a former resident in their DTAs.¹⁵³ The most common DTA provision dealing with capital gains tax on former residents can be found in the DTA signed between Canada and the Netherlands.¹⁵⁴

Countries applying the first model as referred to by Vogel (i.e. the exit tax is established independent from the actual alienation of the asset before termination of residence), such as South Africa and Canada, generally apply a comprehensive capital gains tax system and impose a general exit tax upon emigration regardless of the motivation for terminating residence or the place of new residence.

As mentioned in the previous chapter, Canada have implemented a deferral of exit tax.

In terms of section 220(4.5) of the Income Tax Act of Canada,¹⁵⁵ individuals may elect to defer payment of Canadian exit tax upon emigration if such an individual is unable to pay the departure tax immediately. The payment can be deferred until the date the property is actually disposed of, provided that the individual posts adequate security

¹⁵¹ Vogel, 1082.

¹⁵² Carramaschi, 5.

¹⁵³ Reservation no. 48 of the OECD Commentary on Article 13.

¹⁵⁴ See Article 13(8) of the DTA signed between Canada and the Netherlands.

¹⁵⁵ *R.S.C. 1985, C.1 (5th Supplement)*.

with the Canada Customs and Revenue Agency.¹⁵⁶ Notably, no interest or penalties are levied in respect of a deferred liability.

Furthermore, if the relevant assets are actually disposed of at a price lower than the value determined upon emigration, the taxpayer can elect to adjust the gain reported on emigration by the amount of the subsequent loss. This only applies to taxable Canadian property.¹⁵⁷

Canada includes in its DTAs a clause to reserve the right to tax gains from the alienation of any property derived by a former tax resident on the condition that the alienation takes place during the first six years following emigration.¹⁵⁸

A similar exit tax regime is followed by Australia. When an Australian taxpayer terminates residence, he can elect to opt out of the general tax.¹⁵⁹ This election enables the taxpayer to defer the recognition of gains under the general tax and the payment of such tax until actual realisation of that asset. In making such an election, Australia categorises the asset as "*having the necessary connection*" with the Australian tax jurisdiction of non-residents.¹⁶⁰

It seems as though there are very few countries in the world which applies a comprehensive CGT regime that requires immediate recovery of all exit taxes.

Other countries, like India, does not even treat emigration as a taxable event. When residency is terminated by a resident of India, with no immediate intention of returning to India, the Income Tax Act of India,¹⁶¹ under section 174, recognises the need to only recover taxes from such an individual up to the date of departure. Capital gains are only triggered in the event of an actual disposal of an asset and the concept of taxing accrued gains is not even known in the Income Tax Act of India.

India does not levy exit tax of any kind, but emigrating individuals will still be liable for CGT arising on the transfer of assets situated in India for subsequent years.

¹⁵⁶ In terms of section 220(4.51) of the Canadian Income Tax Act, an individual is not required to post security for the first C\$100,000 of capital gain.

¹⁵⁷ Dyer and Yager, 195.

¹⁵⁸ See Article 13(8) of the DTA signed between Canada and the Netherlands.

¹⁵⁹ De Broe, 193.

¹⁶⁰ Ibid.

¹⁶¹ The Income Tax Act, 1961.

Furthermore, the Indian Revenue Authority has the power to grant instalment payment of tax liability upon furnishing proper guarantees or securities against any CGT liability which arise out of the actual disposal of an asset.¹⁶²

4.3. Summary remarks

This chapter shows that it is possible for exit tax to operate in a manner that will take into consideration the position of the taxpayer without creating an excessive administrative burden for the revenue authority.

Various less restrictive measures are in fact available to levy and collect exit tax. These methods can be summarised as follows:

- i) Collecting the exit tax after emigration in instalments or spread it over a certain period of time after emigration (refer to German exit tax regime).
- ii) Issuing of a preserving assessment for a certain period of time after emigration. If the assets (subject to exit tax) are not sold within the period of the preserving assessment, the assessment should be waived. The fact that the assets are not sold within the specified period is evidence that the taxpayer did not relocate to avoid tax. This method is followed by the Netherlands.
- iii) Providing for a reverse credit for taxes by the immigration country in respect of the assets which was subject to exit tax in the emigration country.
- iv) Deferring exit tax until the actual realisation of the asset provided that sufficient security is provided by the taxpayer (refer to the Canadian exit tax regime).
- v) In the event that South Africa is the immigration country, providing a foreign tax credit for taxes of the emigration country. There should be no requirement that the asset must be disposed of in the year of the deemed disposal (emigration) nor should there be a requirement that the realisation must be within a specific period after emigration (refer to the UK exit tax regime).

¹⁶² De Broe, 313.

Consideration should be given to the impact of the above methods on the current DTAs that South Africa has in place.

Even though requiring an emigration taxpayer to provide security, in the event that his exit tax liability is deferred, may be costly and create administrative difficulties, the SARS should be compensated for the risk of non-recovery, especially if the taxpayer relocates to a tax jurisdiction with which South Africa does not have a DTA. It would therefore be reasonable to request the taxpayer to provide security in such an event.

CHAPTER 5: THE EFFECTIVENESS OF THE LEGAL FRAMEWORK FOR INFORMATION EXCHANGE AND ASSISTANCE IN TAX COLLECTION IN THE CONTEXT OF SOUTH AFRICA

5.1. Introduction

As part of the Community Survey conducted by Statistics South Africa for 2016, data was published which shows that 102,793 South African individuals emigrated over the past 10 years (2000-2016).¹⁶³ The data also shows that the highest portion of this number of individuals relocated to Australia (26%), the UK (25%) and the US (13.4%) during this period.

The adoption of a method whereby the payment of exit tax is deferred will require extensive and effective exchange of information and assistance in collection mechanisms. The aim of this chapter is to examine the effectiveness of the current mechanisms that South Africa have in place in order to evaluate whether these mechanism can be used to track the assets of a former resident and collect exit tax upon actual disposal of the asset. This chapter will explain, in the context of exit tax, how information can be exchanged between revenue authorities in relation to taxpayers' exit tax liabilities, as well as how foreign tax authorities can assist each other in the collection of exit taxes.

Specific reference will be made to mechanisms already in place between South African and Australia, the UK and the US since these countries seem to be the most popular overseas destinations of South African emigrants.

Member States have a number of agreements and treaties in place which provide broad possibilities for administrative cooperation and exchange of information.¹⁶⁴ This enables an effective implementation and functioning of a deferral method. Over and above these treaties, the EU also have the Directive on Administrative Cooperation in place which has the most relevance in EU in relation to intra-EU cross-border exchange of information.¹⁶⁵

¹⁶³ Community survey 2016, Statistics South Africa, 167.

¹⁶⁴ M. Helminen, ed. *Mutual Assistance and Recovery of Tax Claims in Eu Tax Law - Direct Taxation - 2017 (Chapter 6)* (Online Books IBFD: 2017).

¹⁶⁵ Ibid.

The Directive applies to all Member States and provides the Member State with the appropriate tools to collect tax, even if the taxpayer resides in a third Member State. In *Spain v the Commissioner*,¹⁶⁶ (which deals with exit tax) the ECJ held that “*the cooperation mechanisms existing at EU level between the authorities of the Member States are sufficient to enable the Member State of origin to recover the tax debt in another Member State.*” Collecting tax or requesting information in relation to a former resident should therefore not be a problem for Member States.

The current trend toward greater transparency and the exchange of information between revenue authorities should mean that a deferral of exit tax can become a standard solution. This is further motivated by the South African government affirming in the first interim report on BEPS that it is committing to promoting the exchange of taxpayer information for greater transparency in the international tax arena.¹⁶⁷

5.2. Legal instruments for information exchange and assistance in tax collection

The increased desire for taxpayer information is mainly due to technological advancement.¹⁶⁸ This means that a taxpayer can invest and secure his/her money in a tax haven or take advantage of jurisdictions which do not generally keep taxpayer records. This results in taxpayers’ finances and affairs being spread all over the world – either deliberately to avoid tax or merely as a result of a changing technology. Faced with the fact that taxpayers are exploiting tax systems to evade or avoid taxes, information exchange has become increasingly important.

When a taxpayer does not pay his full amount of tax debt or does not pay his tax debt in time, national tax administrations generally have a wide range of powers to enforce such tax debt within the border of their tax jurisdiction. The issue, however, arises when the taxpayer leaves the country and still has outstanding tax debt. When it comes to requesting information from a foreign tax administrator, the initial step for a revenue

¹⁶⁶ *Case C-269/09 Commissioner v Spain*, para 68.

¹⁶⁷ Addressing Base Erosion and Profit Shifting in South Africa – available at <http://www.taxcom.org.za/docs/New_Folder/1%20DTC%20BEPS%20Interim%20Report%20-%20The%20Introductory%20Report.pdf>

¹⁶⁸ Technological advancement essentially means the ability to invest anywhere in the world and still have the ability to access it with the click of a mouse, or the swipe of a credit card.

authority will be to gather and obtain information about the taxpayer's liabilities so as to collect the taxes due.

In the light of exit tax, the tax debt will effectively only arise when the taxpayer is already a taxpayer of another jurisdiction. The taxpayer should therefore have an obligation to inform the emigration country once his assets (subject to exit tax in the emigration country) is actually sold otherwise the emigration country will not know when to collect its exit tax.

If the taxpayer does not inform the emigration country at the time the assets are actually disposed, the emigration country should have the relevant tools in place to assist it in obtaining information regarding the taxpayer' assets and the status thereof. If the assets were in fact disposed of, the revenue authority of the emigration country should have the appropriate mechanisms in place to collect its tax due from the former resident.

In 1998 the OECD published a report¹⁶⁹ to address the issues of "*harmful tax competition*". Harmful tax competition means the aggressive bidding for or poaching of other countries' tax base.¹⁷⁰ This report not only led to the creation of bilateral Tax Information Exchange Agreements ("TIEAs"), but also recommended the development and improvement of tax information exchange, including changes to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ('MCAA').

The following sections evaluate the features of the three main types of agreements used for information exchange and assistance in collection of taxes: bilateral double tax conventions, TIEAs and the MCAA. More specifically, the Model Convention developed by the OECD, because South Africa primarily uses the OECD Model Convention when negotiating its own DTAs and because the majority of the exchange of information provisions in South Africa's DTA, follow the OECD Model Convention.

The model agreements are:

¹⁶⁹ OECD, *Harmful Tax Competition* (OECD Publishing).

¹⁷⁰ Ibid., 15.

- i. the OECD Model Tax Convention on Income and Capital ('the Model Convention');¹⁷¹
- ii. the Model Agreement on Exchange of Information on Tax Matters ('the Model TIEA');¹⁷² and
- iii. the MCAA.¹⁷³

To date, South Africa has signed the MCAA¹⁷⁴ and has a number of multilateral and bilateral agreements in place which contains the exchange of information and assistance in tax collection mechanisms. In terms of bilateral agreements, South Africa has 156 agreements in place¹⁷⁵ and most of these agreements contains some form of exchange of information article.¹⁷⁶ On 6 October 2017, South Africa had 19 TIEAs in place.¹⁷⁷

5.2.1. The Model Convention

Article 26 (Exchange of information) of the Model Convention provides for exchange of information between DTA partners. Article 27 is even more important in the context of exit tax because it provides for assistance in collection of taxes between DTA partners. These articles form the legal basis for exchange of information on request and automatic exchange of information, with the exception of the Model TIEAs which cater only for exchange of information on request.

5.2.1.1. Article 26 (Exchange of information)

Paragraph 1 of this article is the main rule and makes the exchange of information possible by requiring the relevant state to exchange information ("*shall exchange*"):

¹⁷¹ "Model Tax Convention on Income and on Capital 2014 (Full Version)," (OECD Publishing).

¹⁷² Model Agreement on Exchange of Information on Tax Matters and Model Protocol, (Paris: OECD Publishing, 2002).

¹⁷³ OECD/Council of Europe, "The Multilateral Convention on Mutual Administrative Assistance in Tax Matters," (OECD Publishing, 2011).

¹⁷⁴ The instrument of ratifications was submitted on 21 November 2013 – available on the OECD's website.

¹⁷⁵ Available on the SARS' website: <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2013-01%20-%20Status%20Overview%20of%20All%20DTAs%20and%20Protocols.pdf>

¹⁷⁶ J. Roeleveld and C. West, "South Africa" In: International Fiscal Association, 2013 Copenhagen Congress, Cahiers De Troit Fiscal International, "Exchange of Information and Cross-Border Cooperation between Tax Authorities"," (The Netherlands: Sdu Uitgevers, 2013), 687.

¹⁷⁷ Available on the SARS' website: <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-EIA-2013-01%20-%20Status%20Summary%20of%20all%20Tax%20Information%20Exchange%20Agreements.pdf>

“The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provision of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.”

Paragraph 1 enables a revenue authority to share information with the competent authority of a DTA partner that is either “*necessary*”¹⁷⁸ or “*foreseeably relevant*”, depending on the version of the Model Convention that it is based on. Furthermore, it overrides Article 1 (residency provision) and Article 2 (taxes covered) of the Model Convention and requires information exchange for all taxes and not just taxes covered by the convention. It also catches persons who have information in either of the countries, but is not necessarily a tax resident in either of the countries.

This provision is significantly important if a deferral of exit tax method is applied. A taxpayer may relocate from State A to State B (where the relevant asset to which the exit tax relates to was actually disposed of) and shortly thereafter relocate to State C. In terms of the DTA between State A and State B, State A may therefore request information regarding the asset disposal of a taxpayer which is now a tax resident of State C.

The term “*foreseeably relevant*” essentially sets the scope for information that may be exchanged and is “*intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in ‘fishing expeditions’ or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer.*”¹⁷⁹

Since paragraph 1 of Article 26 does not specify the form of information exchange (i.e. requested, automatic, and spontaneous), it is clear that the OECD intended for all three

¹⁷⁸ This was the wording in the pre-2005 OECD Model treaties.

¹⁷⁹ OECD Commentary on Art 26, para 5

forms of information exchange through Article 26 as well as other forms, including general information related to tax administration.¹⁸⁰

Some limitations are placed on the requirement for information exchange in paragraph 3 of Article 26. Subparagraph a and b of this paragraph states that the requested state cannot go beyond the provisions of its own domestic laws in order to fulfil a request and that the requested state does not have to provide more than what the requesting state could obtain under its own laws and administrative practices.

In the UK, for instance, information exchange in relation to a third country resident is possible, but only to the extent that the information is in the possession of a UK resident and the UK has the legal power to obtain the information in terms of its domestic law.¹⁸¹

Further to this, paragraph 4 of Article 26 makes it clear that the limitations in paragraph 3 are not intended to prevent the exchange of information when a requested state has no domestic interest in the requested information. For successful implementation of a deferral method, this will be critical, since the immigration country may have to collect information in relation to the exit tax which is imposed by the emigration country, whilst the immigration country may have no interest in those taxes, or may not even levy CGT or exit tax.

All of the DTAs signed by South Africa have exchange of information provisions or added by protocol. Not all of the exchange of information articles follow the latest version of Article 26 of the Model Convention and not all of South Africa's DTAs provide that the exchange of information will be unrestricted i.e. will apply "to taxes of every kind".¹⁸² This means that the majority of the DTAs apply to taxes governed by the DTA. It is, however, unlikely that such a restriction will hinder the exchange of information with respect to exit tax since the taxes governed by the DTA is usually far -reaching¹⁸³ and the general principle is that exit taxes are covered by the DTAs.

¹⁸⁰ OECD Commentary on Art 26, para 9.1

¹⁸¹ International Fiscal Association. Congress, R. Gómez-Barreda, and X. Oberson, *Exchange of Information and Cross-Border Cooperation between Tax Authorities* (Sdu Uitgevers, 2013), 769.

¹⁸² Congress, Gómez-Barreda, and Oberson, 693.

¹⁸³ Ibid.

5.2.1.2. Article 27 (Assistance in tax collection)

Article 27 was added to the Model Convention in 2003 for the specific reason of taxpayers having assets throughout the world and tax authorities generally cannot go beyond their border to take action to collect taxes in relation to these assets.¹⁸⁴

Previously the general principle of tax law in common law countries was that a country will not assist another country in the enforcement of tax claims of that country.¹⁸⁵ This was confirmed in a South African case, *COT v McFarland*¹⁸⁶ where it was held that “*under common law, South African authorities or the judiciary will not enforce any claim of a foreign state for taxes due and payable.*”¹⁸⁷

Due to globalisation, the OECD was the first to recognise the need for assistance in tax collection. Hence, Article 27 was included in the Model Convention.¹⁸⁸ The OECD even publish a declassified manual based on Article 27 - the ‘Manual on Implementation of Assistance in Tax Collection’. The manual is intended to provide practical and technical advice to revenue authorities involved in assistance in tax collection. Notably, it was developed with the input of both OECD Member and non-OECD Member countries.¹⁸⁹

Article 27 consist of 8 paragraphs. Paragraph 1 sets out a contracting state’s obligation to provide assistance with the collection of “*revenue claims*” as follows:

“The Contracting States shall lend assistance to each other in collection of revenue claims. This assistance is not restricted by Article 1 and 2. The competent authorities of the Contracting States may by mutual agreement settle the mode of application of this Article.”

According to the 2014 OECD Commentary, Article 27 provides for comprehensive collection assistance¹⁹⁰ and it is similar to Article 26 in that it can request assistance

¹⁸⁴ Ibid., 24.

¹⁸⁵ This is also known as the “revenue rule” which essentially stems from the international principle of sovereignty.

¹⁸⁶ *Commissioner of Taxes, Federation of Rhodesia V Mcfarland*, 1 (1965).

¹⁸⁷ A.W. Oguttu, “The Role of International Cooperation in Preventing Tax Evasion: A Critique on “Assistance in the Collection of Taxes” - a South African Perspective,” *Journals IBFD International Tax* 9, no. 68 (2014).

¹⁸⁸ A similar assistance in collection of taxes article was included in the UN Model (2011) also.

¹⁸⁹ Available on the OECD’s website: <http://www.oecd.org/tax/exchange-of-tax-information/oecdmanualonassistanceinthecollectionoftaxes.htm>

¹⁹⁰ 2014 OECD Commentary on Article 27 at para 2.

from another contracting state in respect of a taxpayer who is not a resident of either of the states.¹⁹¹

This article also allows a contracting state to request assistance in relation to a tax that does not exist in the requested state. The Commentary explains that the term “*revenue claim*” applies to any amount in respect of all taxes imposed on behalf of both states,¹⁹² again underlining the wide scope of Article 27.

Importantly, paragraph 1 of Article 27 also provides that the competent authorities may, by mutual agreement, settle the mode of application of this article. In other words, this agreement may cover matters such as the type of documentation that should be provided by the requesting state together with the taxes collected.¹⁹³

It is important to note the conditions under which a request for assistance in tax collection can be made.¹⁹⁴ In terms of paragraph 3, a requested state should not go beyond its own domestic or those of the requesting state in order to fulfil its obligations in terms of Article 27. In addition, the tax debt can only be collected by the requesting state if the taxpayer owing the amount has no administrative or judicial rights to prevent such a collection. In this regard, it is also worth noting that “*many states have rules that provide that a revenue claim can be collected even though there is still a right to appeal...the amount of the claim.*”¹⁹⁵

Another paragraph of Article 27 which may also be helpful when it comes to the collection of exit tax by the emigration country, is paragraph 4. Essentially, paragraph 4 safeguards the collection rights of a requesting state by enabling it to request the other state to take measures of conservancy regarding a revenue claim even where it cannot yet ask for assistance in tax collection.

Like Article 26, Article 27 contains similar limitations in paragraph 8.

Historically, Article 27 was generally not very popular in bilateral DTAs because most countries prefer to implement assistance in collection of taxes in a multilateral manner,

¹⁹¹ 2014 OECD Commentary on Article 27 at para 4.

¹⁹² 2014 OECD Commentary on Article 27 at para 10.

¹⁹³ Oguttu., A.W.

¹⁹⁴ See paragraph 3 of Article 27.

¹⁹⁵ Oguttu. A.W.

like the MCAA.¹⁹⁶ There is, however, an increase in countries willing to engage in assistance in tax collection as a result of the inclusion of Article 27. This is mainly because this article provides requesting states with powers that generally do not exist under their own domestic law.¹⁹⁷

The proper implementation of Article 27 requires a similarity of legal system of the contracting parties to the DTA.¹⁹⁸ It also requires a high level of cooperation between revenue authorities which is the primary reason for issues with regards to the proper implementation of Article 27.¹⁹⁹ Accordingly, some countries, such as Germany, concluded some bilateral DTAs containing Article 27, but only with countries which have comparable legal systems.²⁰⁰

5.2.2. The Model TIEA

TIEAs are treaties which are designed for information exchange with tax havens and is intended to establish the standard for exchange of information for the purpose of the OECD's initiative on harmful tax practices.²⁰¹

TIEAs generally cover only information exchange on request and are negotiated with countries which do not have a comprehensive income tax system as these countries likely do not collect taxpayer information on a regular basis. In June 2015, however, the OECD Committee on Fiscal Affairs approved a Model Protocol to the Model TIEA. The Model Protocol aims to extend the scope of the existing TIEAs to also cover automatic and / or spontaneous exchange of information.

The Model TIEA consist of 16 articles. Article 1 provides the scope of the Model TIEA:

"The competent authorities of the Contracting Parties shall provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by this Agreement. Such information shall include information that is foreseeable relevant to the determination, assessment and collection of such taxes,

¹⁹⁶ Congress, Gómez-Barreda, and Oberson, 24.

¹⁹⁷ Oguttu.A.W.

¹⁹⁸ Congress, Gómez-Barreda, and Oberson, 24.

¹⁹⁹ Ibid.

²⁰⁰ Ibid.

²⁰¹ Commentary to TIEA, 1.

the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters...”

Similar to the Model Convention, the scope of the information that may be exchanged in terms of the Model TIEA is limited to any “*foreseeably relevant*” information. According to the Commentary on Article 1 of the Model TIEA, the term “*foreseeably relevant*” is used in order to prevent situations where information is declined where a definite assessment of the pertinence of the information to an on-going investigation can only be made following the receipt of the information. The scope therefore includes information in relation to the determination, assessment, enforcement or collection of tax with respect to a taxpayer’s tax debt.

Many tax havens does not keep or collect information and records of taxpayers’ transactions. Paragraph 2 provides for this issue by making reference to information “*in its possession*” (in the possession of the requested state), rather than “*available in the tax files*”.²⁰²

Another important article of the Model TIEA, is Article 7 which sets out the circumstances under which a request for information can be declined. Similar to the Model Convention, this provision aims to prevent the requesting state from obtaining and gathering information more than it would be able to in its own jurisdiction.

5.2.3. The MCAA

The MCAA provides for information exchange as well as assistance in tax collection and is “*the most comprehensive and wide-ranging legal instrument for internationally exchanging information...*”²⁰³

The MCAA was developed jointly by the OECD and the Council of Europe. Prior to 2010, the MCAA was open to only OECD members and the Council of Europe. In 2010 the MCAA was amended to allow any state to become a signatory with the aim to increase

²⁰² Commentary to Article 5 of Model Agreement at para 41.

²⁰³ Model Protocol for the purpose of allowing the automatic and spontaneous exchange of information under a TIEA, 1.

information exchange between signatories. According to the OECD's records, 113 jurisdictions currently participate in the MCAA.²⁰⁴

Paragraph 1 and 2 of Article 1 of the MCAA sets out the scope of information exchange and assistance that is intended by the MCAA:

“1. The Parties shall, subject to the provisions of Chapter IV, provide administrative assistance to each other in tax matters. Such assistance may involve, where appropriate, measures taken by judicial bodies.

2. Such administrative assistance shall comprise:

a. exchange of information, including simultaneous tax examinations and participation in tax examinations abroad;

b. assistance in recovery, including measures of conservancy; and

c. service of documents.

3. A party shall provide administrative assistance whether the person affected is a resident or national of a Party or of any other State.”

Essentially, paragraph 1 sets out the objective of the MCAA (which is assistance in tax matters) and paragraph 2 provides the form that such assistance will take. Paragraph 3 allows a party to the agreement to request information from another country about an individual that is not a tax resident of either of the countries.²⁰⁵

Article 2 of the MCAA provides that all forms of taxes (except for customs duties and import/export duties) are covered and has the intention to cover a very wide scope.²⁰⁶

The obligation to exchange information is found in Article 4 of the MCAA and, like the Model Convention and Model TIEA, also makes reference to the term *“foreseeably relevant”*. This article goes on to list the forms of information exchange that are authorised by the MCAA:

- i. Exchange upon request (Article 5);

²⁰⁴ Available on the OECD's website: <http://www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm>.

²⁰⁵ This provision is similar to paragraph 1 of Article 26 of the OECD Model Convention which is intended to cast a wide a net as possible to catch as many taxpayers as possible.

²⁰⁶ Commentary to Article 2 of the CMMA at para 25.

- ii. Automatic exchange (Article 6);
- iii. Spontaneous exchange (Article 7);
- iv. Simultaneous tax examinations (Article 8); and
- v. Tax examinations abroad (Article 9).

Most importantly, the MCAA covers assistance in collection of information and taxes where a taxpayer has assets. The provisions for assistance in tax collection is very similar to Article 27 of the Model Convention.²⁰⁷

Other multilateral agreements to which South Africa is a party includes the South African Development Community Multilateral Agreement on Assistance in Tax Matters ('SADC Agreement') developed by members of the South African Development Community ('SADC'). This agreement is not only used by all the SADC countries to negotiate DTAs amongst themselves, but also with other countries outside the region.

The SADC Agreement contains a provision which is an equivalent of Article 27 of the Model Convention.

A similar agreement was developed in 2012 (the African Agreement on Mutual Assistance in Tax Matters) by the African Tax Administration which in turn promotes and facilitates mutual cooperation among African countries. This agreement establishes the legal platform for African revenue authorities to participate and assist each other with tax matters.

5.3. Exchange of information and assistance in tax collection in the context of South Africa

5.3.1. International instruments

Logically, there are more challenges for the SARS to overcome when obtaining information regarding a taxpayer's cross-border transactions as opposed to those that

²⁰⁷ Countries are allowed in terms of Article 30 to make reservations against providing assistance regarding certain kinds of taxes, but not against automatic exchange of information. Some countries have also limited the types of assistance which they will provide e.g. Italy has limitations on assistance in the recovery of tax claims and the recovery of fines and service documents. Other countries even limits the geographical reach of the convention - *Treaty Commentaries*, Global Tax Treaty Commentaries IBFD and OECD, Revised Explanatory Report to the Convention On Mutual Administrative Assistance in Tax Matters: (Paris: OECD, 2010) at para 55.

take place within the borders of South Africa. These challenges are further complicated when the information needs to be obtained from a tax haven.

South Africa is a member of the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes and is extensively involved in the OECD’s Forum for Tax Administration.²⁰⁸

The Global Forum is essentially a group of countries that aim to fully comply with international standards on transparency and exchange of taxpayers’ information. The Global Forum decided in 2009 to put a peer review mechanism in place for all its members. 50 Jurisdictions took part in the review and South Africa is one of only 18 fully compliant countries.

DTAs and TIEAs signed by South Africa generally conform to traditional exchange of information and do not include alternative means of information exchange.²⁰⁹ Most of the DTAs signed by South Africa were signed before 2003 and, accordingly, does not include Article 27.²¹⁰

Some older DTAs are currently being renegotiated which means that an assistance in collection article may be included, for example the protocols to the DTAs with the UK, the Netherlands and Australia.

Considering specifically the information exchange and assistance in collection mechanisms South Africa has in place with Australia, the UK and the US (the three countries to which the majority former South African residents have emigrated to over the past ten years), the table below shows that South Africa currently have all the tools in place in order to track the assets of former residents and also collect exit tax debt from either of these countries.

Legal platform	United States of America	United Kingdom	Australia
DTA	Article 26 of the DTA provides for both exchange of	Article 26 of the DTA provides for information exchange and follows the OECD Model Convention. The	Article 26 of the DTA provides for information exchange and follows the OECD Model Convention. The

²⁰⁸ Congress, Gómez-Barreda, and Oberson, 688.

²⁰⁹ Ibid.

²¹⁰ Oguttu. A.W.

	<p>information and assistance in collection of taxes.</p> <p>Since the DTA was signed in 1997, the article typically limits the scope of information to be exchanged to information that is <i>“necessary for carrying out the provision of this Convention”</i>.</p> <p>Regarding assistance in collection of taxes, paragraph 4 provides that: <i>“Each of the Contracting States shall endeavour to collect on behalf of the other Contracting State such amounts as may be necessary to ensure the relief granted by the Convention from taxation imposed by that other State does not inure to the benefit of persons not entitled thereto.”</i></p> <p>This paragraph limits the assistance that a country can request to assistance which is necessary to ensure that DTA benefits are enjoyed by the person in terms of the DTA.</p>	<p>scope of information exchange is limited to information that is <i>“foreseeably relevant”</i>.²¹¹</p> <p>Article 25A of the DTA provides for assistance in collection and also follows the wording of the OECD Model Convention.</p>	<p>scope of information exchange is limited to information that is <i>“foreseeably relevant”</i>.²¹²</p> <p>Article 25A of the DTA provides for assistance in collection and also follows the wording of the OECD Model Convention.</p>
TIEAs	South Africa does not have a TIEA with the US.	South Africa does not have a TIEA with the UK.	South Africa does not have a TIEA with Australia.
MCAA ²¹³	The US is a signatory to MCAA. ²¹⁴	The UK is a signatory to MCAA.	Australia is a signatory to MCAA.
Other ²¹⁵	Foreign Account Tax Compliance Model 1A Agreement (2014).	OECD Automatic Exchange of Financial Account Information Agreement (2014).	OECD Automatic Exchange of Financial Account Information Agreement (2014).

²¹¹ See protocol to the 2002 Treaty (2010).

²¹² See protocol to the 1999 Treaty (2008).

²¹³ Status as at 25 October 2017 – available on the OECD’s website.

²¹⁴ The US is, however, the only state which is a party to the original convention.

²¹⁵ These agreements are not discussed in detail.

Even though the exchange of information article in the US DTA still follows the “old” wording, it is submitted that the scope of information exchange (i.e. information which is “*necessary*” for carrying out the provisions of the convention), will include information in respect of those assets of a former South African resident which is subject to exit tax in South Africa. This is provided that the exit tax falls within the ambit of “*taxes covered*” as provided in Article 2 of the DTA signed between South Africa and the US.

The broad scope of Article 26 is confirmed in Technical Explanation to this DTA:

“...taxes covered by the Convention for the purposes of this Article [Article 26] constitute a broader category than those referred to in Article 2 (Taxes Covered). As provided in paragraph 6...covered taxes include all taxes administered by the competent authorities of the Contracting States.”²¹⁶

5.3.2. Domestic provisions

As indicated by Oberson, a large DTA network of a country is not an indication of effective exchange of information.²¹⁷ DTAs should first be properly implemented in the domestic law in order for them to be fully operative.

Chapter five of the Tax Administration Act²¹⁸ (‘TAA’) provides the SARS with far-reaching information gathering powers and supports international exchange of information.²¹⁹ Exchange of information in terms of South Africa’s DTA obligations is specifically provided for in section 3(3) of the TAA. In terms of this provision, the SARS has a legal obligation to gather and exchange taxpayer information internationally.

Section 185 of the TAA gives statutory support to measures in relation to international assistance in tax collection. This section prescribes the manner in which assistance in tax should be provided to DTA partners, including the form that the request must take.

Recent case law shows that the SARS is committed to mutual assistance with foreign tax authorities in the enforcement for tax debts. In *Krok v CSARS*²²⁰ the High Court granted a

²¹⁶ Article 26 of Technical Explanation to the 1997 Treaty (1997), at para 1.

²¹⁷ Congress, Gómez-Barreda, and Oberson, 30.

²¹⁸ Tax Administration Act No. 58 of 1962.

²¹⁹ Congress, Gómez-Barreda, and Oberson, 693.

²²⁰ *Krok v Csars*, 2030/2014 and 20232/2014 (2015).

preservation order to the SARS in respect of the assets of Mr. Krok, a South African resident, who owned approximately R235 million in tax debt to the Australian Tax Office ('ATO'). This was after the SARS received a request for assistance in collection of the tax debt of Mr. Krok from the ATO.

The ATO made the request in terms of Article 25A of its DTA signed with South Africa (the 'SA – Aus DTA') which provides for mutual assistance in collection.²²¹ In terms of the said DTA, the ATO may request the SARS' assistance for collection in taxes if the tax debt is enforceable in Australia and if the taxpayer (owing the debt) cannot prevent the collection in terms of the law of Australia. Accordingly, the SARS is legally obliged to collect the tax debt and may take measures of conservancy (as if the amount was due to the SARS).

Since Article 25A of the SA – Aus DTA only came into force on 1 July 2010, the taxpayer argued that the ATO could not rely on Article 25A in respect of taxes which arose during the year of assessment prior to 2010. The High Court, as well as the SCA rejected this argument on the basis of Article 2.3 which provides that the DTA applied to taxes "*of every kind and description*". Accordingly, the Article 25A has no temporal limitation.

The SARS's far-reaching gathering powers was also illustrated in *Ben Nevis (Holdings) Ltd & Anor v Commissioner for HM Revenue and Customs*²²² where a similar argument was raised by a taxpayer. Ben Nevis Limited argued that the UK Revenue Authority had no legal right to enforce its South African tax liability on the basis that it related to a period before the DTA (signed between South African and the UK) came into force in 2002. He also argued that Article 27 (mutual assistance in collection of taxes) of the protocol could not be applied since it only took effect on 1 January 2003 and his tax debt arose before this date. The UK Court of Appeal rejected this argument on the same basis as the *Krok* case.

Apart from the cases mentioned above, the amount of requests for exchange of information or assistance in collection of taxes by the SARS from the relevant authorities in other jurisdictions, is not publically available knowledge. From the tax

²²¹ The SA – Aus DTA came into force on 1 July 1999 and was amended by protocol signed on 31 March 2008 which made provision for mutual assistance in the collection of taxes.

²²² *Ben Nevis (Holdings) & Anor v Commissioner for Hm Revenue and Customs*, Civ 578 (2013).

cases discussed above and South Africa's involvement in the OECD exchange of information projects it is evident that the SARS is committed to cooperate with tax administrators around the world in order to increase effective exchange of information.

5.4. Summary remarks

A first conclusion can be drawn that South Africa currently do have sufficient information exchange and assistance in collection mechanisms in place in order to adopt and implement a method whereby exit tax is deferred and collected upon actual disposal of assets. Even though this has practically not yet been tested, South African case law indicates that it should be possible for the SARS to operate a deferral of exit tax method.

This chapter also highlights that the intended scope of information exchange and assistance in collection of tax mechanisms is particularly wide (specifically that of the MCAA) and should cover information with respect to exit tax debt.

Even though South African do not have a TIEA with Australia, the UK and the US, in the light of the conclusions reached in this chapter, it is submitted that exit tax can still be collected from a former resident in terms of the DTA or MCAA.

In the event that a taxpayer is relocating to a jurisdiction with which South Africa does not have a DTA it will be almost impossible for the SARS to request for assistance to collect its outstanding tax debt without the legal platform to do so. This risk can be mitigated by requiring the taxpayer to provide sufficient security. If the risk cannot be mitigated, it should be considered to deny the taxpayer a deferral benefit.

CHAPTER 6: SUMMARY REMARKS AND CONCLUSION

This dissertation evaluates whether the current method used by the SARS to levy and collect exit tax is proportional to the legitimate purpose of exit tax – which is to recoup of the benefits and protections offered while the person was a resident.

Exit tax is imposed on unrealised gains and is generally calculated as the difference between the market value (on the day of emigration) and the base cost of the asset.

It is commonly known that there are a number of issues associated with exit tax. The main criticism against exit tax is that the emigrating taxpayer is required to pay tax on a gain which has not actually been realised for income tax purposes on the basis that there was no change in ownership.

This issue is further aggravated when domestic exit tax provisions require that exit tax must be collected immediately upon emigration. Accordingly, the negative cash flow may force the migrant to sell a portion (or all) of his/her assets in order to pay exit tax.

South Africa follows an “immediate recovery” method. This method has raised a number of questions regarding the proportionality of the collection method vis-à-vis the legitimate purpose of exit tax.

Exit tax is essentially about territoriality and tax sovereignty with the purpose to protect a country’s tax base. The ECJ acknowledges the right of Member States to defend their tax base, but concluded that an immediate exit tax recovery method is not worthy of being justified. Canada also recognises the significance of this restriction and have implemented alternative measures which ultimately restores the balance between the purpose of exit tax and the manner in which it is levied and collected.

According to the ECJ it is proportional to establish the amount of exit tax at the time of exit, but it is, however, disproportional to recover the exit tax at the time of exit.

Although this conclusion is done in the European context, it recognises that an immediate recovery of exit tax creates a restriction for the taxpayer.

In the light of the conclusions reached, it is submitted that mere imposition of exit tax may be justifiable and it is not so much the principle of levying exit tax that causes concern, but more the timing and method of the application of these taxes.

The imposition of exit tax by the SARS may be justified. The current method in which the SARS collects exit tax is, however, not proportional because of the cash flow burden it creates.

Other countries have already addressed this issue by implementing alternative measures to levy and collect exit tax, or provide relief in respect of the cash flow burden. These methods have been justified on the basis that they are proportional to the objective of exit tax.

These measures can be summarised as follows:

- i. Collection of exit tax after emigration in instalments or spread it over a certain period of time after emigration. The German exit tax regime follows this method.
- ii. Issuing of a preserving assessment for a certain period of time after emigration. If the assets (subject to exit tax) are not sold within the period of the preserving assessment, the assessment should be waived. This method is followed by the Netherlands in respect of its limited exit tax regime.
- iii. Providing for a reverse credit for taxes by the immigration country in respect of the assets which was subject to exit tax in the emigration country.
- iv. Providing the taxpayer the option to defer the exit tax until the actual realisation of the asset, provided that sufficient security is provided. Canada's exit tax regime follows this method.
- v. In order to prevent a mismatch in the tax base of the asset and to legally bind countries to the application of a step-up in the tax base of the asset, DTAs should include a specific provision to provide for a step-up upon immigration.²²³

In the event that a deferral of exit tax is allowed, the taxpayer should provide security in order to compensate for the risk of non-recovery.

It is further submitted that the taxpayers should have some information obligations when a tax is deferred:

²²³ In the event that South Africa is the immigration country, it is not necessary to provide for a foreign tax credit for taxes of the emigration country, because section 9H provides for a step-up in the base cost.

- i. the taxpayer should file an income tax return in the year of departure which indicates the date residence has been terminated;
- ii. a report should be filed with the above return which sets out all property owned at the date of departure; and
- iii. the former resident should also submit a tax declaration every year to inform the revenue authority about his/her assets and their place of residence.

The next question is whether these methods are practically viable in a South African context. EU Member States have comprehensive measures in place to request information or assistance in collection of taxes. This makes a deferral of exit tax method practically achievable.

Due to increased globalization of investment and trade there have been an increased focus on international cooperation through assistance in collection to enable the effective and fair division of the global tax base. The trend toward greater transparency and the exchange of information between revenue authorities should mean that a deferral of exit taxes can become the standard solution for countries such as South Africa.

South African jurisprudence and the SARS' involvement in international exchange of information programmes is evidence that the SARS is committed to promote exchange of information and cooperate with tax administrators around the world.

Moreover, based on the conclusions reached in the previous chapters, it is submitted that the SARS already have the appropriate legal mechanisms in place to track the assets of former residents and request assistance from foreign tax administrators to collect exit tax debt from a former resident.

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Summary of terms and abbreviations

ATO	Australian Tax Office
CGT	Capital gains tax
Constitution	Constitution of the Republic of South Africa, 1996
DTA	Double Tax Agreement
EC	European Community
ECJ	European Court of Justice
Emigration country	Former country of residence
EU	European Union
Income Tax Act	Income Tax Act, No.58 of 1962
Immigration country	Country of new residence
MCAA	Mutual Administrative Assistance in Tax Matters
Member States	EU Member States
Model Convention	OECD Model Tax Convention on Income and Capital
Model TIEA	Model Agreement on Exchange of Information on Tax Matters
SA – Aus DTA	Double tax agreement signed between South Africa and Australia
SADC	South African Development Community
SADC Agreement	South African Development Community Multilateral Agreement on Assistance in Tax Matters
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
TAA	Tax Administration Act, No 28 of 2011
TEU	Treaty on the European Union
TFEU	Treaty on the functioning of the European Union
TIEA	Tax Information Exchange Agreement
Tradehold	Tradehold Limited
UK	United Kingdom
US	United States of America

Section 9H

Change of residence, ceasing to be controlled foreign company or becoming headquarter company.—(1) For the purposes of this section—

“**asset**” means an asset as defined in paragraph 1 of the Eighth Schedule; and

“**market value**”, in relation to an asset, means the price which could be obtained upon a sale of that asset between a willing buyer and a willing seller dealing at arm’s length in an open market.

(2) Subject to subsection (4), where a person (other than a company) that is a resident ceases during any year of assessment of that person to be a resident—

(a) that person must be treated as having—

(i) disposed of each of that person’s assets to a person that is a resident on the date immediately before the day on which that person so ceases to be a resident for an amount received or accrued equal to the market value of the asset on that date; and

[Sub-para. (i) substituted by s. 14 (1) (a) of Act No. 25 of 2015 deemed to have come into operation on 5 June, 2015 and applicable in respect of (a) (i) any person that ceases to be a resident; or (ii) any controlled foreign company that ceases to be a controlled foreign company in relation to a resident, on or after that date; and (b) any person that becomes a headquarter company during years of assessment commencing on or after that date.]

(ii) reacquired each of those assets on the day on which that person so ceases to be a resident at an expenditure equal to the market value contemplated in subparagraph (i);

(b) that year of assessment must be deemed to have ended on the date immediately before the day on which that person so ceases to be a resident; and

(c) the next succeeding year of assessment of that person must be deemed to have commenced on the day on which that person so ceases to be a resident.

(3) (a) Where a company that is a resident ceases during any year of assessment of that company to be a resident or where a company that is a resident becomes a headquarter company in respect of a year of assessment, that company must be treated as having—

(i) disposed of each of that company’s assets to a person that is a resident on the date immediately before the day on which that company so ceased to be a resident or became a headquarter company; and

(ii) reacquired each of those assets on the day on which that company so ceased to be a resident or became a headquarter company,

for an amount equal to the market value of each of those assets.

[Para. (a) substituted by s. 14 (1) (b) of Act No. 25 of 2015 deemed to have come into operation on 5 June, 2015 and applicable in respect of (a) (i) any person that ceases to be a resident; or (ii) any controlled foreign company that ceases to be a controlled foreign company in relation to a resident, on or after that date; and (b) any person that becomes a headquarter company during years of assessment commencing on or after that date.]

(b) Where a controlled foreign company ceases, otherwise than by way of becoming a resident, to be a controlled foreign company during any foreign tax year of that controlled foreign company, that controlled foreign company must be treated as having—

- (i) disposed of each of the assets of that controlled foreign company, to a person that is a resident, on the date immediately before the day on which that controlled foreign company so ceased to be a controlled foreign company; and
- (ii) reacquired each of the assets disposed of as contemplated in subparagraph (i) on the day on which that controlled foreign company so ceased to be a controlled foreign company,

for an amount equal to the market value of each of those assets.

[Para. (b) substituted by s. 14 (1) (b) of Act No. 25 of 2015 deemed to have come into operation on 5 June, 2015 and applicable in respect of (a) (i) any person that ceases to be a resident; or (ii) any controlled foreign company that ceases to be a controlled foreign company in relation to a resident, on or after that date; and (b) any person that becomes a headquarter company during years of assessment commencing on or after that date.]

(c) Where a company that is a resident ceases to be a resident or becomes a headquarter company during any year of assessment of that company as contemplated in paragraph (a)—

- (i) that year of assessment must be deemed to have ended on the date immediately before the day on which that company so ceased to be a resident or became a headquarter company;
- (ii) the next succeeding year of assessment of that company must be deemed to have commenced on the day on which that company so ceased to be a resident or became a headquarter company; and
- (iii) that company must, on the date immediately before the day on which the company so ceased to be a resident or became a headquarter company and for the purposes of section 64EA (b), be deemed to have declared and paid a dividend that consists solely of a distribution of an asset *in specie*—

(aa) the amount of which must be deemed to be equal to the sum of the market values of all the shares in that company on that date less the sum of the contributed tax capital of all the classes of shares in the company as at that date; and

(bb) to the person or persons holding shares in that company in accordance with the effective interest of that person or those persons in the shares in the company as at that date.

[Para. (c) amended by s. 21 (a) of Act No. 15 of 2016.]

(d) Where a controlled foreign company ceases to be a controlled foreign company during any foreign tax year of that controlled foreign company as contemplated in paragraph (b)—

- (i) that foreign tax year must be deemed to have ended on the date immediately before the day on which that controlled foreign company so ceased to be a controlled foreign company; and

(ii) the next succeeding foreign tax year of that controlled foreign company must be deemed to have commenced on the day on which that controlled foreign company so ceased to be a controlled foreign company.

[Para. (d) amended by s. 21 (b) of Act No. 15 of 2016.]

(e) Where a company ceases to be a resident as contemplated in paragraph (a), the amount of any capital gain disregarded in terms of paragraph 64B of the Eighth Schedule that was determined in respect of a disposal of an equity share by that company within three years immediately preceding the date on which that company ceases to be a resident, must be deemed, in respect of the year of assessment of that company ending as contemplated in paragraph (c), to be an amount of net capital gain derived by that company from that capital gain.

[Para. (e) added by s. 14 (1) (c) of Act No. 25 of 2015 deemed to have come into operation on 5 June, 2015 and applicable in respect of (a) (i) any person that ceases to be a resident; or (ii) any controlled foreign company that ceases to be a controlled foreign company in relation to a resident, on or after that date; and (b) any person that becomes a headquarter company during years of assessment commencing on or after that date.]

(f) Where a company ceases to be a resident as contemplated in paragraph (a), the amount of any foreign dividend that was exempt from normal tax only in terms of section 10B (2) (a) within the three years immediately preceding the date on which that company ceases to be a resident, must be deemed to be a foreign dividend received by or accrued to that company in respect of the year of assessment of that company ending as contemplated in paragraph (c) that is not exempt in terms of section 10B (2).

[Para. (f) added by s. 14 (1) (c) of Act No. 25 of 2015 deemed to have come into operation on 5 June, 2015 and applicable in respect of (a) (i) any person that ceases to be a resident; or (ii) any controlled foreign company that ceases to be a controlled foreign company in relation to a resident, on or after that date; and (b) any person that becomes a headquarter company during years of assessment commencing on or after that date.]

(4) Subsections (2) and (3) do not apply in respect of an asset of a person where that asset constitutes—

(a) immovable property situated in the Republic that is held by that person;

(b)

[Para. (b) deleted by s. 21 (1) of Act No. 31 of 2013 with effect from the date of promulgation of that Act, 12 December, 2013 and applicable in respect of any person that (a) ceases to be a resident; (b) becomes a headquarter company; or (c) ceases to be a controlled foreign company, on or after that date (Editorial Note: effective date in s. 21 (2) of Act No. 31 of 2013 as substituted by s. 147 (1) of Act No. 25 of 2015).]

(c) any asset which is, after the person ceases to be a resident or a controlled foreign company as contemplated in subsection (2) or (3), attributable to a permanent establishment of that person in the Republic;

(d) any qualifying equity share contemplated in section 8B that was granted to that person less than five years before the date on which that person ceases to be a resident as contemplated in subsection (2) or (3);

(e) any equity instrument contemplated in section 8C that had not yet vested as contemplated in that section at the time that the person ceases to be a resident as contemplated in subsection (2) or (3); or

(f) any right of that person to acquire any marketable security contemplated in section 8A.

(5) If—

(a) a person disposes of an equity share in a foreign company that is a controlled foreign company;

(b) the capital gain or capital loss determined in respect of a disposal contemplated in paragraph (a) is disregarded in terms of paragraph 64B of the Eighth Schedule; and

(c) as a direct or indirect result of a disposal contemplated in paragraph (a), a foreign company ceases to be a controlled foreign company,

subsection (3) must not apply to any foreign company contemplated in paragraph (c).

(6) This section must not apply in respect of any company that ceases to be a controlled foreign company as a result of—

(a) an amalgamation transaction as defined in section 44 (1) to which section 44 applies; or

(b) a liquidation distribution as defined in section 47 (1) to which section 47 applies.

[Sub-s. (6) substituted by s. 13 (1) (a) of Act No. 43 of 2014 deemed to have come into operation on 1 January, 2013 and applicable in respect of years of assessment commencing on or after that date.]

(7) For the purposes of subsections (2) and (3), the market value of any asset must be determined in the currency of expenditure incurred to acquire that asset.

[S. 9H inserted by s. 26 (1) of Act No. 24 of 2011, amended by s. 16 (1) of Act No. 22 of 2012 deemed to have come into operation on 1 April, 2012 and substituted by s. 17 (1) of Act No. 22 of 2012 deemed to have come into operation on 8 May, 2012 and applicable in respect of any person that ceases to be a resident, becomes a headquarter company, or ceases to be a controlled foreign company, on or after that date (Editorial Note: effective date in s. 17 (2) (c) of Act No. 22 of 2012 as substituted by s. 193 (1) of Act No. 31 of 2013). Sub-s. (7) added by s. 13 (1) (b) of Act No. 43 of 2014 with effect from 1 January, 2015.]

PLAGARISM DECLARATION

I, Leandi Botha, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorise the University to reproduce for the purpose of research either the whole or any portion of the contents in any matter whatsoever,

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Signature: Date: 7 February 2018