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DUBAI: TAX HAVEN OR TAX TRAP?

Many South African nationals have relocated to Dubai in recent years, most as a result of securing lucrative employment contracts while others have established successful business enterprises. But what are the tax implications? Anton Maskowitz from RMB Private Bank's International Advisory Services team unravels quite a complicated situation.

Dubai, often referred to as the Cote D'Azur of the Middle East, does not levy any taxes on employment or investment income. Unsurprisingly it a magnet for internationally mobile professionals, entrepreneurs and the very wealthy.

A large category of South African professionals employed in Dubai, often leave South Africa with a clear intention to return 'home' at some point in the future. It is not uncommon for these individuals to retain business interests, local investments or property, particularly fixed property, in South Africa.

I often get asked the question by clients: 'What can I do to shelter my offshore earnings or assets from taxation when I return to SA, as I do not have any tax liability now and want to try and keep it that way?'.

The devil is unfortunately in the detail and the answer is not that simple. What many of these South African nationals residing in Dubai do not realise, is that although they are not residing in South Africa, their worldwide income may still be taxable here. Consequently, their *immediate tax position* is generally of far greater importance than a future tax planning strategy.

This is based on South Africa's two tiered approach to income tax residency: you are resident in SA for tax purposes if you are **ordinarily resident** and, in the absence of being ordinarily resident, where you fall within the ambit of **the physical presence test.**

A common misperception is that if you do not spend more than 183 days a year in SA, you are not taxable in that year. The truth is generally far from it!

The physical presence test, or day counting rule as it is often referred to, makes a person resident for tax purposes in SA if you comply with all three criteria of this test:

- present in SA for more than 91 days in the **current** tax year
- present for more than 91 days in each of the **preceding 5** tax years
- were present in SA for a period of more than 915 days in aggregate during that preceding 5 year period

This test is relative straightforward and if you are not physically present in SA for the prescribed periods, then as a taxpayer you would fall outside the ambit of this test.

However, notwithstanding the fact that you may fall outside the scope of this test, the Income Tax Act is clear that the physical presence test will only be relevant if you are not **ordinarily resident.**

The ordinarily resident test, in comparison, is much more complex and contrary to the physical presence test and it is not defined in the Income Tax Act.

The fact that these pertinent *cases Cohen v CIR (13 SATC 362) and CIR v Kuttel (54 SATC 298)* predate the replacement of the source basis of taxation with the residency basis of taxation and the introduction of Capital Gains Tax, muddies the waters even further.

To give guidance on the application of ordinarily residence, SARS issued Interpretation Note 3 on 4 February 2002. Although it does provide some direction, SARS emphasised that the criteria used in this Note is not prescriptive and each case must be tested on its own merits.

The ordinarily residence test is too complex to provide a comprehensive overview here, but the following may prove helpful:

If you have left South Africa and

- have a clear intention to return at some point in the future, and
- have retained various assets or interests here, without formally emigrating, and
- still regard South Africa as your 'real home'

then you are likely to remain ordinarily resident for tax purposes in South Africa during your period of absence.

To fall outside the ambit of the ordinarily residence test, you have to leave South Africa with a degree of permanence. This is a factual test and the courts, in *CIR v Kuttel,* had to determine whether the taxpayer had the intention to leave South Africa permanently.

The fact that he applied for emigration and later formally emigrated from South Africa was held to be indicative of his intention to leave permanently. In addition Mr Kuttel took certain steps to externalise his assets within the confines of the Exchange Control provisions of the time and, as a result, he was held not to be ordinarily resident in South Africa for the particular years of assessment.

Although it is true that foreign employment income is exempt from South African tax if the conditions of section 10(1)(o) are met, this exemption can only apply if you are indeed subject to the Income Tax Act and a resident for tax purposes either in terms of the ordinarily resident or physical presence test.

It is also important to note that SARS view independent contractors i.e. professionals rendering their services on a contractual basis while abroad, as falling outside the scope of section 10(1)(o) and this type of income would remain taxable in South Africa.

The Income Tax Act also places the burden of proof on the taxpayer and where SARS is of the opinion you were ordinarily resident during your period of absence, it is up to you to prove the contrary.

To complicate matters further, Interpretation Note 3 did not deal with an important aspect of the capital gains tax provisions as contained in the 8th Schedule. In terms of para 12(2) of the Schedule, a person who becomes a non-resident, must for the purposes of the Act be treated as having disposed of all his assets other than certain equity shares and rights or instruments obtained in relation to his employment, fixed property or a substantial interest in fixed property and assets attributable to a permanent establishment, which are located in SA.

As a consequence, you would be required to include in your tax return, any deemed gain or loss on assets, such as normal equity investments (listed or unlisted), unit trusts and any offshore investments including fixed property in the tax year you became a non-resident and pay CGT as if you had disposed of the assets.

Apart from the 10% levy payable by emigrants to export assets from SA, you will also have to factor in the Capital Gains Tax consequences of changing tax residency. This is often overlooked, especially where assets are not actually disposed of and can be problematic and financially punitive where emigrants are asset rich and cash poor.

Where deemed disposals are not reflected on emigration, SARS would *de facto* continue to treat you as ordinarily resident in SA during your period of absence.

What does this mean?

Dubai, as part of the United Arab Emirates, does not have a double taxation treaty with South Africa, most notably because they do not impose any meaningful taxes normally covered in a Double Tax Treaty. This unfortunately does not bode well if you are still regarded as ordinarily resident in South African and earning income (other than employment income) or indeed generating Capital Gains while resident in Dubai. In very simplistic terms, you remain fully taxable in South Africa on a worldwide basis.

Foreigners can generally not obtain permanent residency in Dubai and consequently immigration is not an option for South African nationals. Without permanent residency, formal emigration would arguably be much more difficult.

In addition, the South African Estate Duty Act subjects you to estate duty if you are ordinarily resident in South Africa at time of death.

The meaning of ordinarily resident for purposes of the Estate Duty Act is exactly the same as in the case of the Income Tax Act.

If you are relocating to Dubai, it is of the utmost importance to obtain expert tax advice before leaving SA to formulate your income tax resident status. Without arranging your affairs carefully and disclosing the intention to permanently leave South Africa, you may find that you are assessable on income and gains during the period of absence. As a consequence you may be subject to hefty fines and unexpected tax liabilities in the future. In addition, you would then have very limited scope to arrange your affairs in a more tax friendly way, unless you can show that you were neither ordinarily resident nor resident in terms of the physical presence test during your stay in Dubai.

Not exactly the answer you were necessarily expecting to that original question!