When are you a tax resident?

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When it comes to determining whether a person is considered a ‘resident’ for the purposes of being liable for taxation in South Africa, it is important for an individual who ceases to be ordinarily resident in South Africa to be able to factually substantiate a clear intention to leave South Africa permanently, and thereby to ‘break’ ordinary residency in South Africa.

However, this is not necessarily as straightforward as it seems on the face of it. The so-called ‘residence test’ is a highly-complex area of tax law—understandable, since SARS does not have jurisdiction over someone who is not considered a ‘resident’ for tax purposes. This article therefore provides extensive detail on the two tests applied by SARS, namely the ‘ordinarily resident’ test and the ‘physical presence’ test.

The income tax system in South Africa changed from a source-based system of taxation to a residence basis of taxation with effect from years of assessment commencing on or after 1 January 2001. A resident, for South African tax purposes, is defined in Section 1 of the Income Tax Act 58 of 1962 (the Act), as “any— (a) natural person who is— (i) ordinarily resident in the Republic; or (ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic— (aa) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and (bb) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment: in which case that person will be a resident with...
effect from the first day of that relevant year of assessment.” (b) 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 does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation.”

This definition of ‘resident’ also includes definitions of what a ‘day’ is for purposes thereof: “(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a ‘port of entry’ as contemplated in Section 9(1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and (B) where a person who is a resident in terms of this sub paragraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic;

There are a few general observations that may be made in respect of the application of this test to individuals. Firstly there are two separate tests for residence, namely, the test of ‘ordinary residence’, and the ‘physical presence’ test. In other words, two tests are applicable in order to determine whether or not a person is a resident of South Africa—and if either one applies, the individual will be regarded as being ‘resident’ in South Africa for tax purposes.

This is best illustrated by a simple practical example. Assume that an individual passes the physical presence test, i.e. is
not physically present in the Republic for the period stipulated in (aa) and (bb) or (B) of the definition of ‘resident’. However, assuming that the individual is, during that period, ‘ordinarily resident’ in the Republic, the individual will then qualify as a ‘resident’ in terms of Section 1 of the Act.

A second general observation is that any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of South Africa and that other country for the avoidance of double taxation (double tax agreement) is specifically excluded from the definition of a ‘resident’ as defined in Section 1 of the Act.

This represents an acceptance of the ‘tie-breaker’ rule commonly found in double tax agreements to resolve dual residency problems. It is important to note that this effective exclusion applies only if the person is deemed to be exclusively a resident of the other country that is a party to the double tax agreement.

Again we set out a practical example. If, in terms of the tie breaker test in Article 4(2) of the double tax agreement between South Africa and Luxembourg, an individual qualifies as a resident of Luxembourg, then such person will not qualify as a ‘resident’ of South Africa in terms of the definition thereof in section 1 of the Act.

The ‘ordinarily resident’ test The Act does not define ‘ordinarily resident’, and the question of whether a person is ‘ordinarily resident’ is one of fact based on the interpretation given by the courts. In Cohen v CIR, 1946 AD 174; 13SATC 362, it was recognised that it has long been established that a person may have more than one residence for the purpose of income tax, but that whether a person can be ‘ordinarily resident’ in more than one country was unclear. The court suggested that a person’s ordinary residence would
be the country to which they would naturally, and as a matter of course, return from their wanderings. It would be natural to interpret ‘ordinarily’ by reference to the country of their most fixed or settled residence, and therefore a person can only be ‘ordinarily resident’ in one country. In CIR v Kuttel, 1992 (3) SA 242 (A); 54 SATC 298, the court noted that a person may however have more than one residence at a time.

In the Cohen case, the court held that the question of whether an individual was in any one year of assessment ordinarily resident in South Africa, or elsewhere, was not to be determined solely by their actions during that particular year of assessment. Their conditions of ordinary residence during that particular year could be determined by evidence as to their mode of life outside the year of assessment under consideration.

Whilst it does not have any legal effect, it is interesting to note that SARS Interpretation Note No. 3 (issued in 2002) states that a physical presence at all times is not a requisite to be ordinarily resident in South Africa, and that two requirements need to be present, namely, an intention to become ordinarily resident in a country, and secondly, steps indicative of this intention having been or being carried out.

The Interpretation Note states further that a natural person may be resident in South Africa even if that person was not physically presenting South Africa during the relevant year of assessment, and that the purpose, nature, and intention of the taxpayer’s absence must be established to determine whether the taxpayer is still ordinarily resident.

It also sets out a list of factors which SARS will take into account determining whether a person is ordinarily resident in South Africa as follows: • most fixed and settled place of residence; • habitual abode, i.e. present habits and mode of life; • place of business and personal interest; • status of individual in country, i.e. immigrant, work permit periods and
conditions, etc.; • location of personal belongings; • nationality; • family and social relations(schools, church, etc.); • political, cultural, or other activities; • application for permanent residence; • period a broad; purpose and nature of visits; and • frequency of (and reasons for) visits.

The above list is not intended to be exhaustive or specific—it is merely a guideline. The Interpretation Note also states that the circumstances of the individual must be examined as a whole, and the personal acts of the individual must receive special attention. As stated in ITC 1170,34 SATC 76, one is entitled to look at the taxpayer’s life beyond the particular period under consideration.

The ‘physical presence’ test As stated above, in terms of the definition of a ‘resident’ in Section 1 of the Act, a ‘resident’ includes any natural person who is not at anytime during the relevant year of assessment ordinarily resident in South Africa, if that person was physically present in South Africa: • for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as • for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment, and • for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment. It is important to note that in the year of assessment that a taxpayer either ceases to be ordinarily resident in South Africa or commences being ordinarily resident in South Africa, the physical presence test cannot be applied. This is because the physical presence test explicitly only applies if a person was not ordinarily resident in South Africa at any time during the relevant year of assessment.

The effect of the above definition is that a person who is not ordinarily resident in South Africa is, in terms of the physical presence test, a resident after physical presence in South Africa exceeding the above limits over a period of six
consecutive years of assessment.

A person who becomes tax resident by virtue of this test will become a resident from the first day of the year of assessment during which all the requirements of the test are met. Accordingly, an individual would become tax resident in terms of this test from the beginning of the sixth consecutive year of assessment in which they have had a physical presence in South Africa exceeding the above limits.

For the purposes of determining the number of days during which a person is physically present in South Africa, a part of a day is included as a day. A day spent in transit through South Africa is not included as a day, provided that the person does not formally enter South Africa through a “port of entry” as contemplated in section 9(1) of the Immigration Act, 2002. Where a person who is a resident in terms of the physical presence test is physically outside South Africa for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in South Africa, such person is deemed not to have been a resident from the day on which they ceased to be physically present in South Africa. Practical example for individuals wishing to lose their ‘resident’ status. Whilst it is clear that there are two separate tests which both need to be separately passed in order for an individual not to qualify as a ‘resident’, the practical application of these tests can lead to confusion. We therefore set out a practical example to illustrate the relevant principles.

In particular, the example deals with the significance of the ‘physical presence’ test for individuals leaving South Africa in the year following the year in which they lose their ‘ordinary resident’ status. Assume that an individual ceased to be ordinarily resident during the 2010 year of assessment, and that individual then returned to the Republic during the 2011 year of assessment for more than 91 days in aggregate. This occurs not infrequently, that is, individuals emigrate
from South Africa, but are then required to return to South Africa in the following year of assessment in order to carry on their business activities, visit remaining family, etc. In these circumstances, in respect of the 2010 year of assessment the individual would not be ‘ordinarily resident’ in South Africa from the date during that year that the individual left South Africa in the circumstances described in, inter alia, Cohen v CIR (supra). This is itself a topic for discussion, that is, when precisely an individual loses their ordinary resident status.

In terms of the physical presence test, such test only applies to an individual who is ‘not at any time during the relevant year of assessment ordinarily resident in the Republic’. Therefore, this test does not apply during the 2010 year of assessment and, therefore, from the time that the individual loses their ordinary resident status during that year of assessment, they arguably ceases to qualify as a ‘resident’ as set out in Section 1 of the Act. In respect of the 2011 year of assessment, that person, not being ordinarily resident in the 2011 tax year, should then test the requirements of the ‘physical presence’ test. Should that individual have spent more than 91 days in South Africa during each of the preceding five tax years (i.e. in the 2006, 2007, 2008, 2009, and 2010 years of assessment) and more than 915 days in total during that five-year period (which would in all likelihood be the case if they had been ordinarily resident in South Africa during that period), then that individual would arguably again qualify as a ‘resident’ of South Africa by virtue of physical presence with effect from the first day of the 2011 year of assessment.

However, where a person is regarded as exclusively resident of another country in terms of a double tax agreement, they cannot be regarded as a resident for tax purposes in South Africa.

In terms of this analysis, the term ‘relevant year of
assessment’ in (a)(ii) of the definition of ‘resident’ would then refer only to the 2011 year of assessment, and not to all previous years of assessment. In this regard, the ‘relevant year of assessment’ is to be contrasted with the ‘preceding years of assessment’, which therefore supports the interpretation set out above.

**Conclusion** The definition of ‘resident’ as it pertains to individuals contains two principal tests. These are the tests of ‘ordinary residence’ and the physical presence test. An individual must ensure that neither of these tests applies in order not to fall within the definition of ‘resident’ in Section 1 of the Act. An individual will not fall within the definition of ‘resident’ if Residence – Based Taxation they are deemed to be exclusively a resident of another country for purposes of a double tax agreement.

It is in applying the specific provisions of the ‘ordinarily resident’ test and the ‘physical presence’ test to specific factual scenarios that individuals must be careful in planning their affairs.