THE EDUCATION LANDSCAPE IN SOUTH AFRICA IS, MUCH LIKE OUR COUNTRY, VAST AND WIDE, AS IS EVIDENT FROM THE FACT THAT ‘EDUCATION’ RECEIVED THE LARGEST SHARE OF SA’s 2019 BUDGET

THE SOUTH AFRICAN LANDSCAPE

Education

Before considering taxpayers’ education needs, it is important to contextualise the education landscape in South Africa. The education landscape in South Africa is, much like our country, vast and wide, as is evident from the fact that ‘education’ received the largest share of South Africa’s 2019 budget. According to UN data, South Africa allocates a higher proportion of its budget on education than the US, UK and Germany. Yet, the quality of South Africa’s primary education system was rated 116th out of 137 countries in the World Economic Forum’s Global Competitiveness Report 2017/18. The quality of our higher education system is ranked 114th with the quality of maths and science education ranked 128th.

When considering literacy (that is, the ability to identify words), the United Nations Educational, Scientific and Cultural Organisation (UNESCO) found that South African adults have a literacy rate of 94.37% whereas the youth have a literacy rate of 98.96%. This seems impressive, however, when considering more than just the literacy levels, the ‘Progress in International Reading and Literacy Study’ – a study which assesses the reading comprehension and trends in reading literacy – found that South Africa was the lowest-performing country out of 50 countries in 2016. Furthermore, around 78% of South African Grade 4 learners did not have basic reading skills by the end of that school year (contrasted with 4% of learners internationally). Literacy is, therefore, clearly an issue for the youth of South Africa – the future taxpayers of the country.

Taxpayers

Based on the above, the South African Revenue Service (SARS) clearly has its work cut out to ensure that its tax revenue collections continue to flow in from our taxpayers of the future. Tax legislation worldwide has been identified as complex and detailed. When considering ways in which to measure the readability of the legislation, Dale and Chall identified three aspects of the reading process: comprehension, fluency (reading speed), and interest. Richardson and Smith postulated that both comprehension and fluency are important considerations in the readability of tax law, with ‘interest’ being less important. For this reason, they concluded that a definition or measure of readability which does not focus on reader interest is considered more appropriate in circumstances when the readability of tax law is being deliberated.
Various researchers have examined the readability of the income tax legislation, which is the main reference for taxpayers who have the intention to comply. Various readability indexes have been developed for this purpose, one of which is the Gunning Fog Index. This index measures readability based on paragraph, sentence and word length and estimates the years of formal education a person needs to understand the text on the first reading. It is calculated in the following way:

\[ \text{Fog} = (\text{words per sentence} + \% \text{ of complex words}) \times 0.4 \]

where complex words are defined as words with three syllables or more

A Fog Index of 12 requires the reading level of a US high school senior (or a matric in South Africa) who is around 18 years old. Texts for a wide audience generally need a Fog Index less than 12. Texts requiring near-universal understanding generally need a Fog Index less than 8.

An example of how popular consumer publications are ranked according to their readability using the Fog Index is set out in table 1. According to Wylie Communications, aiming for a score lower than the audience’s education is advisable – thus a score of higher than 12 should be avoided as, according to them, even educated people would rather read texts without strain.

**CONCLUSION**

It would be interesting to see South African income tax legislation scores using this index. This information would be valuable to SARS and the National Treasury, especially if the results indicate that the readability is too difficult to understand by the taxpayers that actually need to use it. This will also provide information to determine further taxpayer education initiatives that could be developed to overcome any barriers that might be detected.

Overall, ensuring taxpayers understand the tax legislation will promote trust and produce effective behaviour that will benefit society as a whole – something that all governments should strive for.

### NOTES


5. Developed in 1952 by Robert Gunning, an American businessman who had been involved in newspaper and textbook publishing. Gunning worked with the United Press helping bring the reading level of front-page newspaper stories from the 16th to the 11th grade. He also helped *The Wall Street Journal* reduce its level from 14th to 11th grade. In the process, the journal’s circulation rocketed from less than 50 000 to more than 1 million in a decade [Wiley Communications, ‘The Gunning Fog Index: how low should you go?’, [https://www.wyliecomm.com/2016/04/the-gunning-fog-index/](https://www.wyliecomm.com/2016/04/the-gunning-fog-index/)].


### Table 1 The Fog Index applied to consumer publications

<table>
<thead>
<tr>
<th>Fog Index</th>
<th>Reading level by grade (US)</th>
<th>South African grade equivalent</th>
<th>Reading level by publication in the US</th>
</tr>
</thead>
<tbody>
<tr>
<td>20+</td>
<td>Postgraduate plus</td>
<td>Doctoral degree</td>
<td>US government information</td>
</tr>
<tr>
<td>17−20</td>
<td>Postgraduate</td>
<td>Honours or master’s degree or postgraduate diploma</td>
<td>Academic journal papers</td>
</tr>
<tr>
<td>16</td>
<td>College senior</td>
<td>Fourth year</td>
<td>Standard medical consent forms are written at the 16th-grade level</td>
</tr>
<tr>
<td>15, 14, 13</td>
<td>College junior, sophomore, freshman</td>
<td>College or university student</td>
<td>No popular consumer publication is this difficult</td>
</tr>
</tbody>
</table>

**Third year, second year, first year**

| 10     | High school sophomore      | Grade 10 (high school)         | *National Geographic* |
| 9      | High school freshman       | Grade 9 (high school)          | *Reader’s Digest* |
| 8      | 8th grade                  | Grade 8 (high school)          | *Ladies’ Home Journal* |
| 7      | 7th grade                  | Grade 7 (high school)          | *TV Guide, The Bible, Mark Twain* |
| 6      | 6th grade                  | Grade 6 (high school)          | *People, Parade* |

Source: Gunning-Mueller Clear Writing Institute Inc adapted with comparative South African terminology.
TAX IMPLICATIONS
WHEN A TRUST VESTS AN AMOUNT FOR EDUCATING BENEFICIARIES

WHAT ARE THE TAX IMPLICATIONS IF AN AMOUNT IS VESTED BY A TRUST IN A BENEFICIARY FOR EDUCATIONAL PURPOSES?

There are very few benefits that employers can provide to their employees that do not result in a tax. One of those that do applies where the employer grants any bona fide scholarship or bursary to an employee, or to a relative of an employee, of the employer. Where section 10(1)(q) of the Income Tax Act 58 of 1962 applies, this will result in an amount accruing to the employee that will be exempt from normal tax, or partially so. There will then be no taxable benefit for purposes of the Seventh Schedule either.

Section 10(1)(q) exempts from normal tax any bona fide scholarship or bursary granted to enable or assist any person to study at a recognised educational or research institution. Section 10(1)(qA) provides the same exemption to someone who is a person with a disability as defined in section 6B(1) of the Act. This exemption also applies to employees or their relatives as was indicated above, but that is not relevant here.

A trustee of a trust resident in the Republic of South Africa (RSA) wondered if the exemption would also be available to the beneficiary of the trust who is also a resident of the RSA and is a minor child. In this instance the trust deed provided that the trustees could spend money on the education of the beneficiaries of the trust.

The beneficiary of the trust – the minor child in this instance – doesn’t have a vested right to the income or capital of the trust. The money was therefore spent by the trust after the exercise of a discretion vested in the trustees of the trust to do so.

Should the beneficiaries have had a vested right to the income and the ‘income’ was used to pay for a beneficiary’s education, it will not be exempt from normal tax. This is so because in terms of section 25B(1) of the Act, the ‘income’ would have been deemed to have accrued to the beneficiary directly. The payment of the educational expenses is then effectively, and from a tax point of view, treated as having been paid by the beneficiary. Put differently, the amount so used accrued to the beneficiary as ‘income’ and is not a receipt of accrual of a bona fide scholarship or bursary and the section 10(1)(q) exemption will not apply.

This is not relevant for purposes of this article as the beneficiary in this instance didn’t have a vested right.

SECTION 7(3) OF THE ACT

In all instances where amounts were received by, or accrued to, the trustees of a trust, one must always determine if section 7 of the Act applies. This is very important as it may deem the amounts so received to have actually been received by someone other than the beneficiary (or the trust). That someone else is commonly referred to as the donor.

Because we have, based on the facts, a minor child here, it must be determined if section 7(3) may apply. It will apply, ‘if by reason of any donation, settlement or other disposition made by that parent of that child –

(a) it has been received by or has accrued to or in favour of that child or has been expended for the maintenance, education or benefit of that child; or

(b) it has been accumulated for the benefit of that child.’

Note that section 7(3) specifically refers to ‘income’ that has been ‘expended for the education of’ a minor child. But it doesn’t apply in all instances. It only applies where income that was used for the education of the beneficiary arose ‘by reason of any donation, settlement or other disposition made by that parent of that child’.

Where for instance the asset that produced the income that the trustees used for the education of the minor was donated to the trust by a parent of the minor (as beneficiary of the trust), the amount expended for the education of the minor will be deemed to be that of the parent of the minor child. It also applies where the asset that produced the income was funded by the parent of the minor child by way of an interest-free loan account (as is also common).

The question now is whether the parent can argue that this amount, the amount that is deemed to have accrued to him or her in terms of section 7(3) of the Act, is a bona fide scholarship or bursary and that it is therefore exempt from normal tax. There is a problem in principle with the view that it would be.

The effect of section 7(3), or any of the section 7s for that matter, is to deem the amounts that have accrued to the trust to be amounts that have been received by the parent. It doesn’t allow, in a sense, for the amount to change its nature from income – let’s say it was derived by the trustees from the amount of rental (net of expenses) of a property owned by the trust – to a scholarship or bursary.

The parent of the minor child would then not qualify for the section 10(1)(q) exemption. Simply put, because it is rental that accrued to the parent (deemed) and not a scholarship or a bursary.

WHAT IS THE POSITION WHERE SECTION 7, SPECIFICALLY SECTION 7(3), DIDN’T APPLY?

Because the trust is a discretionary trust, the tax consequences will follow from the application of sections 25B(1) and 25B(2) of the Act. In this instance an amount was received (the net rental) by or accrued to or in favour of a person (or persons – the trustees) during any year of assessment in his or her (or their) capacity as the trustee of a trust. Section 7 doesn’t apply, but the amount, the amount so received or accrued, has been derived for the immediate or future benefit of any ascertained beneficiary.

Section 25B(2) provides that where a beneficiary has acquired a vested right to any amount in consequence of the exercise by the trustee of a discretion vested in him or her in terms of the relevant deed of trust, that amount must be
deemed to have been derived not for the benefit of the trust but for the benefit of that beneficiary.

This requires the trustees to exercise their discretion in the year of assessment that the gross rental accrued to the trust. Once the trustees decided to vest the amount in a beneficiary, they have exercised their discretion and the amount is deemed to have accrued to, or received by, the child.

WOULD THE EXEMPTION APPLY IN THIS INSTANCE?
The words used in section 10(1)(q) are the following:

‘There shall be exempt from normal tax, any bona fide scholarship or bursary, other than any scholarship or bursary contemplated in paragraph (qA), granted to enable or assist any person to study at a recognised educational or research institution.’

GRANTED TO ENABLE OR ASSIST ANY PERSON TO STUDY AT A RECOGNISED EDUCATIONAL OR RESEARCH INSTITUTION
According to the practice generally prevailing, the phrase ‘bona fide scholarship or bursary granted’ refers to financial or similar assistance granted to enable a person to study at a recognised educational or research institution. Because the amount was expended in respect of a minor child, one would expect it to be in respect of school fees. The section, albeit in relation to assistance granted to enable or assist any relative of an employee so to study, or bursary granted’ refers to financial or similar assistance granted to enable or assist any person to study at a recognised educational or research institution.

WILL THE BENEFICIARY, THE MINOR CHILD, QUALIFY FOR THE EXEMPTION?
It was already said that where section 7 applies and the amount spend on the education of the child is deemed to accrue to the parent, the exemption is not available. Section 25B, where section 7 doesn’t apply, deems, in much the same way as does section 7, the amount vested to have accrued to the beneficiary directly. So, let us for the moment assume that the trustees vested an amount in cash in and paid same out to the beneficiary. If the beneficiary (or his or her parents on his or her behalf) then uses this money to pay the school fees, applying the same logic, one would say that there was in fact no scholarship or bursary and that the exemption doesn’t apply.

One would be inclined to think where the trustees were authorised to give bursaries in general – in other words to persons not specifically listed as beneficiaries of the trust – that the exemption would be available. That would be correct because it would factually mean that the decision was to grant a scholarship or bursary and that decision caused the vesting to take place. It is submitted that the fact that section 25B will deem the net rental income to have accrued to the person (the recipient) would not change the fact that there was a scholarship or bursary in the first place.

The question is whether the fact that the trustees directly paid an amount to the recognised research institution will mean that the beneficiary qualifies for the exemption. Let’s look at an example (taken from M v M and Others (559/2007) [2015] ZAGPPHC 66 (4 February 2015):

‘The trust deeds authorise the trustees to determine what the nature of the benefits will be, who the beneficiary from the beneficiaries, mentioned in the respective trust deeds, will be and what the reason for the payment is. The trustees also decide if the payment should be in the form of cash or goods and if it should be paid directly to the beneficiary or to someone else on behalf of the beneficiary.’

The tax consequence of a payment made from the capital of the trust will of course not have tax consequences for the beneficiaries and the fact that it is exempt under section 10(1)(q) will be irrelevant. But if the trustees used the net rental income in the trust to pay the school directly, the someone else on behalf of the beneficiary, the fact is that it still is an amount of rental that was vested in the beneficiary (in terms of the trust deed) and will be deemed to accrue to the beneficiary (in terms of section 25B). It still is an amount of income that was vested by the trustees in the beneficiary and the fact that it was to assist the child (beneficiary) to study would then be irrelevant.

But if the trust deed specifically authorised the trustees to assist a beneficiary of the trust to by way of a bursary or scholarship to study, and the decision was taken by the trustees to do so, then it would constitute a bursary or scholarship and the exemption would apply. The fact that the trustees used the income of the current year that is then deemed not to accrue to the trust to do so would then be irrelevant and the exemption would apply.
EXPAT TAX
LOOMING ‘EXPAT TAX’ IS ULTIMATELY FAIR

On 1 March 2020, the amended section of the Income Tax Act concerning the foreign employment income exemption comes into effect. This so-called ‘expat tax’ has caused concern among South Africans working abroad who currently pay no tax if they meet certain criteria. From next year, only R1 million of this income will be exempt from tax here.

Given the practical and administrative changes that would need to be implemented, on 6 March 2019 National Treasury held a workshop to discuss concerns that employers and employees will be faced with. Treasury indicated that they will not consider any policy changes and that the R1 million exemption will not be increased.

Let’s look at this without the emotion attached. If an expat is earning money outside South Africa but still owns property, has a family who lives here and wants to be seen as a South African, it is realistic for such a person to be required to pay some level of direct tax. And the R1 million threshold is quite reasonable considering the tax thresholds enjoyed by employees working in South Africa.

If an expat is already paying direct tax in another country, then the effect of the new South African tax may be mitigated by tax paid elsewhere in terms of a double tax agreement with possible minimal effect. However, it is likely to be felt the most by those people working in tax havens, many of whom have high levels of indirect taxes such as VAT but where there is no payroll tax.

WHO DOES TREASURY HAVE IN THEIR SIGHTS?

For individuals earning less than R1 million abroad, this new amendment will have little impact, but Treasury is more likely to be targeting individuals such as pilots or oil rig workers who effectively retain a base in South Africa but work for an offshore company. Until now, these individuals were exempt from paying tax in South Africa despite enjoying the benefits of their families living in the country.

It will be a challenge for someone who until now has not been paying tax to start doing so, but the impact might not be as large as has been reported. It is worth noting that the first R1 million of income is completely tax free,
which is already a significant benefit if you are working in a country with a low tax bracket. You will only start paying tax in South Africa on the first rand earned from employment after that R1 million.

**BE SURE TO SEEK THE BEST ADVICE**

Of greater concern is the misinformation currently circulating around financial emigration, which is being touted as a way of continuing to pay no tax. This is not true: financial emigration does not necessarily exempt you from paying tax in South Africa.

In spite of emigrating, you are still liable to pay tax on any South African-sourced income and may also be found to be tax resident. Exchange control residence and tax residence are two different issues, although formal emigration is a way to show the intention to break your tax residence which has a capital gains tax implication. It is therefore essential that you obtain the correct advice from a qualified tax practitioner before making any decisions or applications regarding your assets and tax affairs.

Another problem is people who left South Africa years ago although they have not emigrated financially. They may no longer be tax resident in South Africa because they have been living abroad for such a long time. They should try to clarify their status as taxpayers, but it is unlikely that the intention is that the South African Revenue Service (SARS) be able to apply the expat tax to them. It should be noted that expats who have not been submitting tax returns in South Africa although they were still South African tax residents and thus ought to have done so are in default with SARS and financial emigration will not fix their tax compliance issue in retrospect.

**CROSS-BORDER INFORMATION-SHARING: NO PLACE TO HIDE**

It is also worth noting the impact of cross-border information-sharing on the implementation of this expat tax.

First, since expats have always been required to complete a tax return in South Africa even if they were exempt from paying income tax on foreign employment income, this information is already available to SARS. On top of that, owing to information sharing between countries and banks, SARS will know exactly how much is paid into anyone’s bank account.

Information-sharing agreements were specifically noted by Finance Minister Tito Mboweni in his 2019 National Budget as a key focus area for fixing SARS and tightening the tax net. This means that expats too will increasingly be on SARS’s radar, underlining the importance of ensuring that your affairs are in order and in compliance with these new proposed amendments.
AMIDST THE USUAL AND EXPECTED TAX CHANGES ANNOUNCED IN THE 2019 BUDGET SPEECH BY FINANCE MINISTER TITO MBOWENI WAS A PROPOSAL THAT THE OECD MANDATORY DISCLOSURE RULES BE IMPLEMENTED IN SOUTH AFRICA. WHAT ARE THESE RULES, WHAT DO THEY INTEND TO ACHIEVE AND WHAT BENEFITS CAN BE REALISED FROM THE SUCCESSFUL IMPLEMENTATION OF THESE RULES?

On 9 March 2018, the Organisation for Economic Co-operation and Development (OECD) published the mandatory disclosure rules (MDR) for Common Reporting Standard (CRS) Avoidance Arrangements and Opaque Offshore Structures. These rules were largely designed to address any financial arrangements or structures that are or were designed to assist a taxpayer in directly or indirectly evading tax by either (a) circumventing being reported under the CRS or (b) identify offshore structures created with aim of providing beneficial owners with a veil of secrecy (such as complex offshore trusts).

In addition, the MDR specify the parties that have disclosure obligations should the arrangement or structure fall into either category (a) or (b) above. These parties include a promoter, which is any person who is responsible for the design or marketing of the CRS avoidance arrangement or opaque offshore structure, and a service provider, which is any person that provides relevant services in respect of a CRS avoidance arrangement or opaque offshore structure and could have reasonably known that the arrangement or structure is a CRS avoidance arrangement or opaque offshore structure. In some cases, the taxpayer themselves are required to disclose certain information. This may occur for instance when a promoter or service provider cannot disclose the information to their tax authority due to professional secrecy and confidentiality rules that they are bound by. In this case, they will have to notify the taxpayer that the taxpayer themselves have certain disclosure obligations.

The information to be reported to the relevant tax authorities by the parties above goes so far to include a factual description of the features of the arrangements and exactly how circumvention of CRS reporting and beneficial owner secrecy was achieved. The OECD believes providing this sort of information to tax administrations will enable these administrations to further strengthen compliance activities, exchange information with treaty partners and enable better tax policy design all of which will help in the fight against tax evasion.

The further concern for taxpayers is that the OECD suggests that the MDR should be applied retrospectively meaning that past structures may still be brought to light. Also mentioned in the budget was that similar penalties to those currently in force for non-compliance with the reportable arrangement legislation will be imposed for non-compliance with the MDR.

On face value, implementing these rules certainly shows the commitment of South Africa to the initiative of information-sharing with other jurisdictions. It will enable the South African Revenue Service (SARS) to identify and report to other jurisdictions taxpayers who are avoiding tax in those jurisdictions through elaborate schemes. It is assumed therefore that SARS themselves expect the same data-rich information in return from these foreign jurisdictions so they can enforce tax collections and add to their desperately needed tax collections target.

For now, the following questions remain: Will SARS adopt the OECD MDR rules verbatim or will there be additional requirements? What impact will this legislative add-on have on the already exhaustive regulatory burden that the automatic exchange of information places on financial institutions? As usual the budget is only the appetizer and we await further details in the draft legislation.