# SEEKING ANSWERS FROM EUROPE: A CRITICAL ANALYSIS OF THE SOUTH AFRICAN EXIT TAX REGIME

Keith Tait[1]

## Introduction

The intention of this dissertation is to analyse what lessons South Africa can learn from the experience that The EU has had with regards to its own regime and explore how it can apply this to its own exit tax regime by extrapolating the EU's best practices. The need for such an analysis and comparison is in many respects urgently needed, especially in light of South Africa's emergence onto the world stage following its recognition as a member of the nations with emerging economies known by the acronym BRICS, which occurred formally on 24 December 2010.[2]

This move has been met with scepticism and apprehension by some. Jim O'Neill, the Goldman Sachs economist who first coined the anagram BRIC, is one of those who have voiced scepticism about the inclusion of South Africa within the purview of the BRIC nations. He is on record as stating that "South Africa's economy is very small; for South Africa to be treated as part of BRIC doesn't make any sense to me. Yet South Africa as a representative of the African continent is a different story."[3]

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1 Keith Tait, LLB, LLM (Tax) with Distinction, is a recent graduate of Queen Mary University of London, Centre for Commercial Law Studies. Keith received the prize for the top tax student on the LLM in Tax Programme in 2014. This article is based on his LLM dissertation which achieved a distinction. Keith may be contacted at keithdtait@yahoo.com

2 Nasreen Seria, 'South Africa Is Asked to Join as a BRIC Member to Boost Emerging Markets' <www.bloomberg.com/news/2010-12-24/south-africa-asked-to-join-bric-to-boost-cooperation-with-emerging-markets.html> accessed 21st December 2013

3 Ibid

The argument that shall be put forward in this dissertation is that in South Africa's haste to join this club of emerging nations, it has made the fatal flaw of failing to considering whether or not its institutions are up to the challenge of stepping out onto the world stage.

It is argued that, in its haste to be recognised in this way, South Africa may be compromising its ability to maximise its potential and take full advantage of the opportunities that membership of BRICS could potentially represent. In many respects, what is happening represents movement away from the desired outcome; instead of achieving the desired goal of appearing as a strong and stable economy, South Africa now looks increasingly vulnerable. One major consideration in this respect is the country's tax system, which involves South African companies paying the second highest effective tax rate among the 60 largest global economies, whilst still suffering one of the smallest tax bases in the world and with among the lowest proportions of employers and companies paying tax.[4]

The vulnerability of South Africa's tax system and the case for reform is starkest when looking at the country's exit tax regime.

This rapid emergence of South Africa onto the world stage has placed the government under pressure, both at domestic and international level, to find new ideas to review and enhance its tax system. This point can be best illustrated by the recent compilation of the South African Tax Review Committee. The Committee's mandate is to assess South Africa's tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability.[5]

The previous South African Finance minister Pravin Gordhan has highlighted the need for new ideas and evaluation. He has stated that "given the pace of globalisation, the relatively modest economic growth after the 2008/2009 economic recession, and the significant social challenges such as persistent unemployment, poverty and inequality, the Government believes that there is a need to review what role the tax system can play as part of a coherent and effective fiscal policy framework in addressing these challenges. The committee has therefore been constituted, to evaluate the South African tax system against

4 Mike Schussler, 'Are South Africa companies the highest taxed in the world? Page one, economists.co.za, <http://www.economists.co.za/info_det.asp?Type=Art&ID=39> accessed 3rd March 2014

5 Lorys Charalambous, 'South Africa's Tax review committee to start work' (Legallaw.com 2013) <www.tax-news.com/news/South_Africas_Tax_Review_Committee_To_Start_Work 61455.html> accessed 3rd March 2014

international tax trends, principles and practices, as well as recent international initiatives to improve tax compliance and deal with tax base erosion."[6]

What this dissertation intends to argue is that the EU could provide the solutions that South Africa is currently seeking. The premise of this statement is based upon a combination of factors such as the economics of the current situation that South Africa and the EU each find themselves in and the legal framework that each entity ultimately operates within.

Currently, the EU's membership stands at twenty eight member states, and in many respects the supranational organisation is at the cutting edge of international tax policy thanks largely due to the sheer size of its internal market, which operates over twenty eight Member States, which combined comprises one of the largest GDPs in the world and a total population in excess of 505 million people[7], as well as the disparity between the domestic fiscal policies of each of its 28 Member States.

It therefore stands to reason that the lessons learnt within the EU through the case law and jurisprudence of the Court of Justice of the EU should be seriously considered in terms of its applicability within the South African context.

The manner in which this dissertation will approach and unfold this area of study shall be threefold; in chapter one it will focus on the respective exit tax regimes of The EU and in chapter two the focus will fall on South Africa's regime.

The approach is that by looking at each system individually, it will become clearer how the respective exit tax regimes evolved, what their purposes were and how each entity went about achieving its intended purpose within the specific context, in which each found itself during their development.

The analysis of the respective regimes shall be carried out in the two chapters through the lens of the respective case law. The emphasis of the analysis itself shall focus on are the various historical challenges and problems that the respective exit tax regimes have had to face and also the manner in which the regimes have responded to the various challenges which they have come up against. At the end of each chapter there shall be a reflection on the academic thoughts and debates surrounding each exit tax regime.

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6 Ibid

7 Europa.Eu, 'Interesting facts' <http://ec.europa.eu/internal_market/20years/singlemarket20/facts-figures/interesting-facts_en.htm> accessed 2 January 2014

Then to conclude, this dissertation shall highlight potential solutions that have been applied through European Union tax case law and jurisprudence in dealing with the various challenges which have emerged in the exit tax regimes of various European Union member states in order to illustrate how they could potentially provide solutions to the current problems facing the South African exit tax regime.

## Chapter 1

## European Exit tax regime

### Overview of the evolution of the European exit tax regime

The crux of the issue when dealing with a subject such as exit tax is that the concept and what it encapsulates is inherently discriminatory in nature, as shown by its highly controversial past.

The first example of this past controversy can be found in the Nazi tax laws which were enacted against the Jewish nation from 1934 onwards within the German Republic.

Those who managed to leave Germany before the Holocaust began had much of their wealth seized through an 'exit tax'. Estimates vary, but by having Nazi officials seizing and selling the property of Jews through taxes like this, both in Germany and in the nations which were occupied by the Nazi regime during World War II, estimates suggest that as much of 30% of the Nazi war effort was funded through taxes collected under laws such as this.[8]

The second example of this dark past can be found once again in the position that the Jewish people found themselves in their attempts to emigrate from the Soviet Union during the 1970s and 1980s. In 1972, the Soviet government began to impose "a head tax on all emigrants with higher education."

This tax, dubbed "the diploma tax", was imposed by the Soviet Government with the rationale that they wished to take back the money spent on the state education of Jewish professionals. In some cases, this fee amounted to more than a decade of annual salaries and thus made it impossible for many professionals to leave.[9]

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8 Hans-Peter Ullmann, 'A third of Nazis' war effort funded with money stolen from Jews', <http://www.worldjewishcongress.org/en/news/9687/a_third_of_nazis_war_effort_funded_with_money_stolen_from_jews_study_finds> accessed 15 December 2013

9 Sydney Heller and Derek Groom, 'A Struggle against Oppression: An Analysis of Jewish Emigration from the Soviet Union during the 1970s and 1980s', UCLA International Institute

What this shows is that, historically, exit tax has been predicated on discrimination and for this reason it is mired in controversy. Arguably, this discriminatory rationale can and does potentially persist in the application of EU exit taxes.

The beginning of any discussion on the EU and how it operates in terms of its legal structure has to begin with the assertion of the supremacy of European Union law over all the member states, a supremacy which is exercised partially through the Court of Justice of the EU (CJEU). This new legal order was affirmed by three cases, the judgment in each case building upon the last in order to explain how this new order works and how it operates. These three cases are *Costa v ENEL*[10], *Van Gend en Loos v Nederlandse Administratie der Belastingen*[11] and *Humblet v Belgian State*[12].[13]

The idea of how efficiently the new legal order naturally flowed into the various tax systems of each of the member states has been an area of debate, yet what the case law shows is this happened with almost immediate effect.

The first example of this immediate effect of the new legal order can be seen in the case of *Humblet v Belgian State*[14], which took place on 16th December 1960, whereby the right of the Member States to tax Community officials came under scrutiny as competence in relation to the taxation of salaries of Community officials had been transferred to the Community.[15]

Consequently, the Court held that remuneration paid to Community officials was withdrawn from "the Member States' sovereignty in tax matters and transferred to the Community's institutions."[16]

The case of *Van Gend en Loos v Nederlandse Administratie der Belastingen (1963)* saw the court openly declaring the inauguration of this new legal order, proclaiming this by stating the following: "In addition, the task assigned to the Court of Justice under Article 177, the object of which is to secure uniform

10 Case (6/64) Flaminio Costa v ENEL [1964] ECR 585

11 Case 26/62, *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v Nederlandse Administratis der Belastingen* [1963] ECR 1

12 [1960] ECR 559

13 Tom O'Shea, 'EU Tax Law and Double tax conventions', (Avoir Fiscal Limited 2008), p76-77

14 [1960] ECR 559

15 Tom O'Shea, 'EU Tax Law and Double tax conventions', (Avoir Fiscal Limited 2008), p76-77

16 Ibid

interpretation of the treaty by national courts and tribunal, confirms that the states have acknowledged that community law has an authority which can be invoked by their nationals before those courts and tribunals.

The conclusion to be drawn from this is that the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and that the subjects of the new order comprise not only member states but also their nationals. Independently of the legislation of member states, community law therefore not only imposes obligations on individuals, but it is also intended to confer upon them rights which become part of their legal heritage."[17]

The case of *Costa v ENEL* built and elaborated on the fact that, not only was there a new legal order that existed within the Community, but that the rules governing the member states were subservient to the Community laws.

The Court ruled that this entitlement derived from a variety of factors, namely: from the spirit of the EU's Treaties; from the fact that a new legal system had been established; from the creation of the EU's framework and institutions; and from the limitations imposed on the sovereignty of the Member States together with the transfer of powers to the EU. It also noted that Community Regulations were binding and directly applicable in all Member States.

It went on to comment that, "the obligations undertaken under the treaty...would not be unconditional, but merely contingent, if they could be called into question by subsequent legislative acts of the signatories. The transfer by the States from their domestic legal system to the Communities legal system of the rights and obligations arising under the Treaty carries with it a permanent limitation of their sovereign rights, against which a subsequent unilateral act incompatible with the concept of the Community cannot prevail."[18]

So it stands to reason that with the building blocks of the supremacy of Community law having been laid down and subsequently exercised when the Community was still in its infancy, this supremacy is now, in many respects, one of its strengths. The results that are been seen now are the accumulation of sixty-three years of refining and moulding the various approaches and understandings of the member states.

17 Case 26/62, *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v Nederlandse Administratis der Belastingen* [1963] ECR 1 para 3

18 Case (6/64) *Flaminio Costa v ENEL* [1964] ECR 585

The primary problem that the concept of exit taxes would face within an environment such as the internal market, derives from the principles which underpin and ensure the smooth running of the internal market. Exit taxes are arguably discriminatory in nature and violate "the four fundamental freedoms" which ensure the internal market's functionality and, broadly speaking, prohibit any form of discrimination, unless there is a justification. Succinctly put, the four freedoms operate on the premise that there has to be the freedom to provide services (Article 56)[19] and establishment (Article 49)[20],workers movement (Article 45)[21], goods (Articles 26, 28 to 37)[22] and capital (Article's 63 to 66).[23]

Through its domestic legislation, individual Member States have the potential to breach the principles of the internal market and inhibit or prohibit the freedoms from operating. States are allowed to act in this manner, but only under certain pre-defined circumstances. For example, the pre-existence of certain conditions may allow Member States to cite considerations such as public policy, security and health as defined under directive 2004/38/EC[24] as a legal basis for exemptions from the obligation to obey these principles, should the need arise.

The above point is best illustrated by the *Cassis de Dijon* judgement, whereby this concept of the "rule of reason", was developed by the court. Under this rule a restrictive national measure is acceptable if it protects a legitimate public interest, and its restrictive effects do not go any further than necessary to protect that legitimate interest.[25]

The case of *Gilly*[26] is helpful as here the CJEU ruled that as long as "no unifying or harmonising measures for the elimination of double taxation has been adopted at Community level, the Member States may define the criteria for allocating their

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19 European Commission, 'The EU Single Market', accessed 3rd of March 2014 at: <'http://ec.europa.eu/internal_market/top_layer/living_working/services-establishment/index_en.htm>

20 Ibid

21 European Commission, 'The EU Single Market', accessed 3rd of March 2014 at: <'http://ec.europa.eu/internal_market/top_layer/living_working/services-establishment/index_en.htm>

22 Ibid

23 Ibid

24 Ibid

25 Ben J.M. Terra, Peter J. Wattel, 'European Tax Law - 6th Edition', (Walters Kluwer 2012) p 41

26 C-366/96

powers of taxation as between themselves, with a view to eliminating their double taxation"[27]

The following two exit tax cases show these rules in effect, within the legal framework outlined above.

The first of these is the *Daily Mail* case[28], which involved the UK-based newspaper publishing group Daily Mail and General Trust Plc seeking to transfer its seat of incorporation to the Netherlands for tax purposes.

Section 482(1)(a) of the UK Income and Corporation Taxes Act 1970 prohibits companies resident for tax purposes in The UK from ceasing to be so resident without the consent of the Treasury. The Daily Mail group saw this as a violation of its freedom of establishment.

On application to the CJEU, the Court noted that the UK Treasury's consent was required "only where such a company seeks to transfer its central management and control out of The UK while maintaining its legal personality and its status as a UK company"[29]

The Court went on to rule that that Articles 52 and 58 of the EEC Treaty cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State.[30]

In other words, the Court ruled that freedom of establishment, even though it was one of the freedoms that under pinned the internal market, could not be activated for the plaintiff, as their actions, in transferring their central management and control to another Member State where prohibited by the company law rules that where in force at the time.

The second case of Cartesio[31] shows once again the question of freedom of establishment been applied and subsequently challenged. The facts in this case concerned a Hungarian LLP which wished to move its seat to Italy and remain a Hungarian LLP in the process. Under Hungarian law, this was deemed to be impossible.

27 *Gilly* C-336/96 paragraph 30

28 C- 81/87

29 *Daily M*ail C- 81/87 paragraph 18

30 Ibid operative part

31 C-210/06

The manner in which the Court reached its judgement was by applying its *Daily Mail* judgment. The Court held that a company was a legal person and, as such, was a creature of national law and existed 'only by virtue of the national legislation which determines its incorporation and functioning'.

The Court went on to determine that under Hungarian law a company which transferred its seat to Italy lost its status as a Hungarian company, with the consequence that it was required to reincorporate itself in Italy.[32]

Essentially the court went on to state that the current state of affairs contained within the fact pattern of the case was a breach of the freedom of establishment. Such a barrier to the actual conversion of a company, without prior winding-up or liquidation, into a company governed by the law of the Member State to which it wishes to relocate constitutes a restriction on the freedom of establishment of the company concerned which, unless it serves overriding requirements in the public interest, is prohibited under Article 43 EC.[33]

What this shows is that exit taxes can challenge the underpinning rules of the internal market, yet there has to be a justification for the Member State to act in the manner in which it does.

The European Commission has requested that several Member States amend their legislation in the field of exit taxation, or have started infringement cases to force Member States to amend their legislation.[34]

It is precisely this controversial discriminatory conundrum which exit tax poses; how does a sovereign nation in the 21st century deal with this issue, especially in light of the increasingly mobile and interconnected global community. The strength of EU tax law and the answers that it provides are particularly helpful in addressing this conundrum.

## Case law analysis to help understand how it was formed and why it formed in the manner in which it did

Exit taxation seeks to tax a latent gain on an asset made by a departing entity, be it in the situation whereby the asset hasn't been realised, or even when leaving ones country of residence. Yet any tax-paying entities which are remaining or domiciled

32 T. O'Shea,' Exit Taxes Post –Cartesio', The Tax Journal, [2009] 1-2

33 *Cartesio* C-210/06, paragraph 110-113

34 Reinout Kok , ''Exit Taxes for Companies in the European Union after National Grid Indus' volume 21 [2012] EC Tax Review page, 201

in the country in question are not subject to this tax or will only be taxed once the asset has been realised, putting those which are departing at a distinct disadvantage to those which remain behind.

In order to further heighten the controversial nature of the concept, should the state in question feel it to be appropriate, it can deploy a wide range of defences in order to justify the approach that they have taken with regards to the claimant, should a legal challenge occur.

Therefore due to its arguably discriminatory nature, the area of justifications and proportionality is the key to unlocking and understanding this area.

The CJEU has accepted only three—arguably four—justifications for this discrimination when applying the “rule of reason”, namely the need to protect the coherence of the national tax system (fiscal coherence), the need for effective fiscal supervision and the need to prevent tax avoidance, fraud and abuse. The fourth contentious area which some commentators would also include is the concept of fiscal territorial area, as touched upon in the *Futura*[35] case.[36]

Even though the concept of exit tax is controversial, it is very much a commercial reality which exists for companies doing business around the world, in whatever capacity they may find themselves operating.

In order to delve more deeply into how the EU’s exit tax works in reality, it is useful to start by looking at how exit taxation has been applied in cases concerning individuals. From there, this dissertation shall then move onto commercial cases and an examination of how the cases against individuals and companies interrelate in an effort to illustrate the evolution of the exit tax regime within the EU.

The first case that shall be looked at is the case of *Hughes de Lasteyrie du Saillant v Ministère de l’Économie, des Finances et de l’Industrie*[37]. In this case, Mr de Lasteyrie du Saillant, a French tax resident, decided to move his residence from France to Belgium in September 1998.

In his observations before the CJEU, Mr de Lasteyrie indicated that he had moved his tax residence to Belgium for the purpose of carrying on his profession. In moving, he was caught by a provision in the French General Tax Code, namely

35 Case C-254/08

36 J.M. Terra, Peter J. Wattel, ‘European Tax Law - 6th Edition’, (Walters Kluwer 2012) p 105

37 Case C-9/02

Article 167a of the *Code Général des Impôts (CGI).*[38]

He held, or had held at some time during the five years preceding his departure from France, either directly or indirectly with members of his family, securities conferring entitlement to more than 25% of the profits of a company subject to corporation tax and established in France.

The market value of those securities being then higher than their acquisition price, de Lasteyrie was taxed on the increase in value in accordance with Article 167a of the CGI and implementing provisions.[39]

In response to this, de Lasteyrie submitted the question as to whether the French exit tax provisions, codified in Decree No 99-590 and expressed in the CGI which provided for taxation of increases in value only when tax residence is moved outside of France, may have violated the principle of freedom of establishment guaranteed by Article 43 of the EC Treaty.[40]

In the submissions before the court, one of the arguments put forward by the German and Danish governments was that Article 167a of the CGI does not constitute an obstacle to the freedom of establishment. They argue that that provision is not discriminatory, nor does it directly or indirectly prevent French nationals from establishing themselves in another Member State.[41]

Yet the most enduring justification that was put forward in this case was actually made by the Netherlands government and not the French. The overarching notion that they put forward was one of coherence of the tax system.

Their argument was along the lines that the combined effect of taxation at the time of removal abroad and the requirement for guarantees to which the grant of suspension of actual payment of the tax is made subject is necessary to ensure the coherence of the French tax system as there is a direct link between the postponement of the annual taxation of the growth in capital corresponding to the securities and the actual collection of the tax at the time when the taxpayer moves his tax residence abroad.[42]

38 *De lasteyrie du saillant* C-9/02 para 20 and 21

39 Ibid paragraph 12

40 Ibid paragraph 13

41 Ibid paragraph 21

42 *De lasteyrie du saillant* C-9/02 para 61

Yet this justification was not accepted. The Court ruled that Article 167a of the CGI does not appear to be aimed at ensuring generally that increases in value are to be taxed, in the case where a taxpayer transfers his tax residence outside of France, in so far as the increases in value in question are acquired during the taxpayer's tenure in French territory.

That finding was supported by the fact that the tax system allowed exoneration in respect of all taxation to which increases in value, where realised, and have been subject in the country to which the taxpayer transferred his tax residence. Such taxation might have the consequence that realised increases in value, including the part of them acquired during the taxpayer's stay in France, are entirely taxed in that country.

The premise on which the Netherlands Government's argument, concerning fiscal coherence, is based does not hold true having regard to the aim pursued by the tax system laid down by Article 167a of the CGI. Therefore, justification for such a system based on an objective of fiscal coherence cannot be accepted.[43]

With regards to the justification of tax avoidance, the Court ruled that it should be noted that Article 167a of the CGI is not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law, but is aimed generally at any situation in which a taxpayer with substantial holdings in a company subject to corporation tax transfers his tax residence outside France for any reason whatever (see, to that effect, ICI , paragraph 26, and X and Y , paragraph 61).

However, the transfer of a physical person's tax residence outside the territory of a Member State does not, in itself, imply tax avoidance and cannot justify a fiscal measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty

The Court's summary stated that the answer to the question referred must be that the principle of freedom of establishment laid down by Article 52 (now, after amendment, Article 43 EC of the Treaty) must be interpreted as precluding a Member State from establishing, in order to prevent a risk of tax avoidance, a mechanism for taxing latent increases in value such as that laid down by Article 167a of the CGI, where a taxpayer transfers his tax residence outside that State.[44]

The solution put forward by the European Commission on the back of the ruling was in many respects also based upon the decision reached in the case of *N v*

43 Ibid paragraphs 63 - 65

44 Ibid paragraph 69

*Inspecteur van de Belastingdienst Oost/kantoor Almelo*[45], also referred to as the *N* case.

The fact pattern of the *N case* is similar to that in *de Lasteyrie* as it involves an exit charge imposed on a migrating individual, this time a Dutch citizen migrating to The UK. The migrating individual happened to own a substantial shareholding which had significant unrealised gains at the time of N's migration. Whilst the CJEU accepted that a Dutch exit tax could be imposed on this gain, it required that taxation to be postponed until the shareholding was disposed of.

In short, the court ruled that a Community national who had been living in one Member State since the transfer of his residence and who held all the shares of companies established in another Member State, may rely on Article 43 EC.[46]

The court also ruled that Article 43 EC must be interpreted as precluding a Member State from establishing a system for taxing increases in the value of rights in a company, in the case of a taxpayer transferring his residence outside that Member State, which makes the granting of deferment of the payment of that tax conditional on the provision of guarantees, and does not take full account of reductions in value capable of arising after the transfer of residence by the person concerned, and which were not taken into account by the host Member State.[47]

An obstacle arising from a requirement in breach of Community law that a guarantee be constituted cannot be raised with retroactive effect merely by releasing that guarantee. Where a Member State makes provision for the payment of interest on arrears, where a guarantee demanded in breach of national law is released, such interest is also due in the case of an infringement of Community law.

It is for each of the national court to assess, in accordance with the guidelines provided by the Court and in compliance with the principles of equivalence and effectiveness, whether the Member State is liable for the damage caused by the obligation to constitute such a guarantee.[48]

The case law above shows that the immediate taxation of latent capital gains on assets been transferred to another Member State infringes the principle of freedom of establishment.

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45 C-470/04

46 C-470/04 N v Inspecteur van de Belastingdienst Oost/kantoor Almelo (see para. 30, operative part 1)

47 Ibid (see para. 55, operative part 2)

48 Ibid (see (see para. 67, operative part 3)

Practically speaking though, the cases mentioned above demonstrate that taxpayers will be discriminated against when they are subject to immediate taxation within their Member State of origin on capital gains, which have not yet been fully realised at the time they wish to exit the country, if there is no provision for taxation to be levied on these same amounts for those who wish to remain within the country.

The case law also shows that it is not possible for a disproportionate burden to be put on the taxpayer. Examples of measures designed to ensure that this is the case include imposing bank guarantees and placing taxpayers under an obligation to appoint a representative who would stand as a guarantee for the payment of the tax when the asset is subsequently realised in the taxpayer's new country of residence. The European Commission in their report 'Exit taxation and the need for co-ordination of Member States tax policies' affirmed what the court had already ruled on, by saying that taxing residents on a realisation basis and departing residents on an accruals basis, does comprise a difference in treatment which constitutes an obstacle to free movement. Where a Member State decides to assert its right to tax gains accrued during a taxpayer's residence within its territory, it cannot take measures which constitute a restriction to free movement.

This rules out the possibility of immediate collection of the tax due on the unrealised gains when taxpayers move their tax residence to another Member State. The CJEU ruled in *de Lasteyrie* and in the *N* case that the possible suspension of payment made subject, for example, to conditions that guarantees must be provided, constitutes a restrictive effect in that the taxpayer is deprived of enjoyment of the assets given as a guarantee. Similarly, it is clear from *de Lasteyrie* that suspension of payment cannot be made subject to the condition of designating a representative in the Member State of origin. In general, any means of preserving the tax claim must be strictly proportional to that aim and must not entail disproportionate costs for the taxpayer.[49]

**Case law analysis revolving around the challenges posed and how these challenges were solved**

The question which then follows is this: if the above information pertains to how individual taxpayers are to be treated, how then would this approach be applied when dealing with more complex entities such as companies?

49 Commission of the European Union, 'Exit taxation and the need for co-ordination of Member States' tax policies', page 4: http://ec.europa.eu/taxation_customs/resources/documents/taxation/com(2006)825_en.pdf

The importance of this question lies in the idea that companies have a separate legal personality from those of their owners. This approach is a legal doctrine which is accepted worldwide.

Within the law of The UK the idea that a company can take on a separate legal personality is an idea that first found support in the *case of Sutton's Hospital*[50]. In this case, it was ruled that the company's personality rests only in intendment and consideration of the law as "a corporation aggregate of many is invisible, immortal and rests only in intendment and consideration of the law."[51]

Bearing the above in mind, the precise nature of the legal system under which any given company operates is highly influential on its operation. Therefore a distinction has to be made between countries which have an incorporation system and countries which have a real seat system.

In an incorporation system, a company remains in existence if it transfers its place of effective management abroad. However, typically that company can, based on domestic tax legislation and/or tax treaties, no longer be taxed by the country under whose legislation it was established. In the EU, as the Member State of origin loses its taxing rights over companies which move to other Member States for tax purposes, it is more than likely the case that the government of the country of origin aims to levy an exit tax on the built-in gains within the assets and liabilities of the company.

Under a real seat system, a company is in principle dissolved if it transfers its place of management to another jurisdiction. If that dissolution results in taxation over the built-in gains in the assets (and liabilities) of the company, such taxation is technically not an exit tax. The taxation is levied not because the company migrates, but because the company is dissolved.

That a company ceases to exist as a result of the transfer of its real seat is in itself not an infringement of EU law. The CJEU has ruled that the life and death of companies is in the hands of a Member State and exercising that power to decide over life and death of a company is in principle not restricted by EU law.[52]

Challenges have, however, also appeared under the incorporation system and questions have been posed through prominent cases such as *National Grid*[53],

50 (1612) 77 Eng Rep 960

51 Ibid (paragraph 32 b)

52 Reinout Kok , ''Exit Taxes for Companies in the European Union after National Grid Indus' volume 21 [2012] EC Tax Review page, 201

53 C-371/10

*Commission v Denmark*[54] and *DMC Beteiligungsgesellschaft mbH*[55], known as the *DMC* case.

It is of course important to bear in mind that exit taxation itself is not an infringement on the freedom of establishment, and therefore not forbidden under EU law, although immediate recovery of the exit tax is. The question which needs answering is therefore this: at what moment can the Member State legitimately recover its exit tax?

When reading paragraph 87 of the ruling in *National Grid Indus BV*[56], it can be inferred from the context that recovery must wait until the built-in gains in the assets and liabilities of the migrating company are realised. In this paragraph, it was ruled that Article 49 TFEU must be interpreted as not precluding domestic legislation of a Member State under which the amount of tax on unrealised capital gains relating to a company's assets is fixed definitively, without taking account of decreases or increases in value which may occur subsequently, at the time when the company, because of the transfer of its place of effective management to another Member State, ceases to obtain profits taxable in the former Member State; it makes no difference that the unrealised capital gains that are taxed relate to exchange rate gains which cannot be reflected in the host Member State under the tax system in force there.

So by precluding legislation of a Member State whose legal system prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the very time of that transfer, the question the is: when are built-in gains being realised?

The facts of *National Grid* involved Netherlands-based National Grid Indus (NGI) relocating its place of effective management from the Netherlands to the UK. NGI held a sterling denominated receivable on a UK group company which showed an unrealised foreign exchange gain at the time of emigration. NGI's tax residency was changed to the UK after relocation, with the result that its profits, including any unrealized gains, were only taxable in the UK. This change of effective management triggered a Dutch exit tax liability.

The questions which were placed before the CJEU comprised the following: first, can the taxpayer rely on Article 43 (now 49) of the EC Treaty, if the Member

54 C-261/11

55 C-164/12

56 C-371/10

State applies a final settlement tax on the transfer of the place of effective management?

If the answer is yes to the first question, then the second question is this: is a final settlement tax, not permitting the possibility of deferring that tax and without the possibility of taking account of subsequent decreases in value after the transfer of the effective place of management, justified by the necessity of allocating powers of taxation between the member states?

Then, third, does the answer to this question depend on whether the final settlement tax is levied on a gain which would not be recognised as a profit in the other state?

It was held that NGI could rely on Article 43. The point to note here is that the Dutch legislation did not, unlike the *Cartesio* and *Daily Mail* cases, facilitate a change to the company's legal status and thus did not affect whether the company could rely on Article 43, the contention that was under review here is that the legislation applied a tax charge on the transfer of the effective management of NGI.[57]

The answer to the second question was also, broadly speaking, yes. The Dutch rules placed a cash-flow disadvantage on NGI which does not arise if the effective management is relocated within the Netherlands. This deters companies relocating which is a restriction on the freedom of establishment.

The fact pattern shown in National Grid the Court illustrated that a corporate exit tax could in principle, be justified on the grounds of preserving a balanced allocation of taxing rights, but it was viewed to be more proportionate to give taxpayers a choice between immediate taxation and deferral.[58]

The answer to the third question was no, as it matters not whether the tax is levied on a gain which would not arise in the 'receiving' State. In short, the CJEU found that an exit tax which does not give the right to defer payment until the gain becomes realised is not proportionate.

It was ruled that giving taxpayers a choice between immediate taxation and deferral were both considered proportionate measures, depending on the situation that the company found itself in. The reasoning is that the administrative burden associated with deferral such as tracing and recording the assets in question may outweigh the disadvantage of having to pay tax at the time of exit. This was

57 *National Grid Indus* C-371/10 para 33

58 Ibid para 86-87

particularly likely in cases involving a complex of business assets. In such cases, immediate taxation was no less proportionate a solution than deferral.[59]

The CJEU did, however, rule that an exit tax regime that does not take into account subsequent decreases in the value of assets is not as such in breach of the freedom of establishment. The CJEU went on to rule, in paragraph 86, that legislation covering an exit tax should have two options: the immediate payment of tax on unrealised gains; and a deferment until the disposal of the asset (potentially with interest). The amount would be fixed – the timing could differ.

The Court acknowledged that the risk of non-recovery increased with the passage of time, and ruled that Member States may introduce measures such as a bank guarantees in order to ensure collection, although this should only be required where there is a genuine and serious risk of non-recovery.[60]

The court also ruled that the Treaty offers no guarantee to a company covered by Article 54 TFEU that transferring its place of effective management to another Member State will be neutral as regards taxation. Given the relevant disparities in the tax legislation of the Member States, such a transfer may or may not be to the company's advantage in terms of tax, according to circumstances.[61]

Succinctly put, what the above shows is that procedures and structures are in place which enable a company incorporated in an EU Member State in which national law allows the company to remain in existence, to transfer its place of effective management, within the EU and in doing so, it shall be protected by the freedom of establishment.[62]

The case of *Commission v Denmark*[63] saw the European Commission take issue with the Danish Corporate Tax Act, specifically section 8, paragraph 4 of the Act, which covers the transfer of assets and liabilities abroad. This is deemed to be a disposal at fair market value upon the transfer of these assets and the section also rules that the liabilities are no longer subject to taxation after the transfer. The capital gain was deemed to be taxable during the year of the transfer with no possibility to apply for a deferral of the tax payment. What was subsequently

59 Barry Larkin, 'DMC: a step backward in understanding exit taxes?' KPMG EU Tax Centre [2014] page 2

60 *National Grid Indus* C-371/10 para 74

61 Ibid para. 62

62 Ibid para. 1

63 C-261/11

found was that because the rules in place required an immediate recovery of the exit tax, these rules where disproportionate.[64]

What is pertinent to bear in mind with regards to the background of the case is that this case was built upon a pre-existing foundation of case law that, among other aspects, saw the possibility of an exit tax been justified in situations where the balanced allocation of powers of taxation between Member States was threatened. Yet if a Member State wishes to pursue this line of argument, it has to be pursued in accordance with the principle of territoriality linked to a temporal component, since the Member State is merely exercising its power of taxation in relation to gains generated in its territory.[65]

The questions posed centred around two main concepts, namely the issue of proportionality within the EU exit tax regulation framework and the issue of deferment and the treatment of assets that were not meant to be realised within the exit tax was also touched upon.

With regards to the issue of proportionality, the CJEU ruled that an exit tax levied on assets reallocated from Denmark to another Member State constitutes an obstacle to the freedom of establishment, this was due to the different treatment of comparable situations.

It also went on to rule that its clear from case law that a Member State could justify a exit tax in ensuring the balanced allocation of powers of taxation between Member States in accordance with the principle of territoriality linked to a temporal component, since the Member State is merely exercising its powers of taxation in relation to gains generated in its territory.[66]

The purpose of deferring the payment of exit tax is to avoid cash flow problems for the taxpayer by the immediate recovery of the exit tax. The recovery of the tax at the time of the disposal of the asset as defined in national legislation is considered proportionate and must be the starting point and the basis of the main rule.[67]

64 Ibid para 40

65 *National Grid Indus* C-371/10 Para. 45-47, *Commission v Portugal* C-38/10 Para. 31, *Commission v Spain* C-64/11 Para. 31, *Commission v Denmark* C-261/11 Para. 32 and *Arcade Drilling* E-15/11, Para. 93. All of this case law shows the principle of preserving the allocation of powers of taxation between the Member States as a legitimate objective and it's been recognised by the Court

66 *Commission v Denmark* C-261/11 para.32

67 *National Grid Indus* C-371/10 para 86

The fact pattern in *Commission v Denmark* showed that part of the argument put forward by Denmark was that the conclusions reached in the *National Grid Indus* case were limited to assets which would eventually be disposed of anyway. [68]

Yet such a narrow interpretation was clearly rejected by the CJEU. Nevertheless, the CJEU stated that the fact that the assets are not disposed of does not preclude the Member State from recovering the tax upon the company's emigration.[69]

The Court ruled that "the Member states, which are entitled to levy tax on the capital gains arisen while the assets in question were located within their territory, are thus entitled to provide an alternative criterion for the taxation than the actual disposal in order to ensure the taxation of assets, which are not intended to be disposed of, which is less restrictive of the freedom of establishment than the taxation at the time of the transfer."[70]

Therefore, the predominant rule is that a deferral must be offered for all assets until the disposal of the asset. Only in relation to assets which are not intended to be disposed of are Member States entitled to provide an alternative criterion not in relation to all assets. The CJEU did not give any examples or details in relation to proportionate alternative criteria which can limit the period of deferral for exit taxes on assets not intended to be disposed of.[71]

Case law states that it is proportionate for national legislation to offer a company two choices: on the one hand, the choice for immediate payment of the amount of tax, which creates a disadvantage for that company in terms of cash flow, but frees it from administrative burdens; and on the other, the deferral of the payment of the exit tax, which necessarily involves an administrative burden for the company in connection with tracing the assets. It therefore seems proportionate to require notification of the exit alongside the tax return as in the Danish proposal as well as to require annual notification of the location of the assets.

Case law further states that, as a general rule, the deferral must be granted until the disposal of the asset. Yet, in *Commission v Denmark* the CJEU approved the use of an alternative criterion, but only in relation to assets not intended to be disposed of. Yet the alternative approach advocated was that the deferred tax

68 *Commission v Denmark* C-261/11 para 35

69 Ibid para 36

70 Ibid para 37

71 Michael Tell, 'Exit Taxation After *Commission v Denmark* C-261/11'Corit Advisory, [2013] 15

would become payable in instalments, in order to guarantee taxation of assets that are unlikely to be disposed of.

What could prove useful with regards to the abovementioned points is that a common measure used in many countries is the concept of a time-limited deferral and/or payment in annual instalments, which was used in cases such as *Commission v Denmark*. Whether the recovery of the exit tax in annual instalments is proportionate must, on the basis of *Commission v Denmark*, be evaluated on three considerations: cash flow problems for the taxpayer; ensuring the Members State's actual taxation of the asset; and to be less restrictive than the immediate payment. Ultimately, the balancing of the considerations is the key issue when applying them to the fact pattern of individual cases.[72]

It was also ruled that, with regards to the recovery of exit tax, mandatory recovery of the exit tax at the time of migration/reallocation would always be disproportionate.

It is, however, proportionate for national legislation to offer a company a choice between: (1) immediate payment of the exit tax, which creates a disadvantage for that company in terms of cash flow, but frees it from an administrative burden; and (2) deferral of the payment of the exit tax, which necessarily involves an administrative burden for the company in connection with tracing the assets.[73]

The case of *DMC Beteiligungsgesellschaft mbH*[74] involved a German reorganisation whereby, in essence, two Austrian corporate partners in a German limited partnership exchanged their partnership interests with a German limited company (GmbH) in return for shares in the company.

As a result, the partnership collapsed into its single partner, the GmbH. The GmbH maintained the book values of the transferred assets, which was allowed under the Reorganisation Tax Act 1995 (RTA) only if the new shares issued as consideration were subject to tax in Germany.

The German tax authorities considered that the transfer gave rise to a taxable gain, based on the going concern value of the partnership interests rather than the lower book value at which they had been transferred.

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72 Ibid page 16

73 Michael Tell, 'Exit Taxation within the European Union/European Economic Area – After *Commission v. Denmark* (C-261/11) Corit Advisory, [2013] 2

74 C-164/12

German law provided for such a valuation where a gain on the consideration shares would not be taxable in Germany. The referring court agreed with the tax authorities that Germany could not tax the shares as a result of the Austria-Germany tax treaty. In the case of German resident partners the assets could have been transferred at book value.

Yet under German law there was a provision for the option to pay the tax over a 5-year period subject to providing security. However, this was not good enough for the former partners, who claimed that not being able to complete the share transfer at book value was in breach of the EU's free movement of capital principles.[75]

In considering the case, the CJEU worked on the assumption that the unrealised gains on the partnership assets had effectively been removed from the German tax jurisdiction since after the exchange the gains were embodied in the consideration shares and Germany could not tax these by virtue of the tax treaty, causing some observers to question how the notion of a "phased deferral" works. [76]

The Court was asked two questions. The first of these is whether Article 49 TFEU must be interpreted as precluding the legislation of a Member State which requires assets contributed by a partnership to the capital of a capital company with its registered office in the territory of that Member State to be assessed at their value as part of a going concern, thus giving rise to the taxation—before they are in fact realised—of the capital gains arising in that territory on those assets, on the basis that that State cannot exercise its powers of taxation in relation to those capital gains when they are actually realised.[77] The second question posed was, in essence, whether the legislation at issue in the main proceedings and the restriction it entails go beyond what is necessary to attain the objective of preserving the balanced allocation of the power to impose taxes between Member States.[78]

The CJEU ruled that "the legislation at issue in the main proceedings is liable to deter such investors from having holdings in a limited partnership governed by German law, since they will be required, in the event of the subsequent conversion of their holdings into shares in a capital company, to pay immediately the tax on any profit in connection with the unrealised capital gain generated in Germany, if they are no longer, due to the conversion of their holdings, subject to such tax in the future in Germany."[79]

75 Barry Larkin, 'DMC: a step backward in understanding exit taxes?' KPMG EU Tax Centre [2014] p 1

76 Ibid page 1

77 *DMC* C-164/12 para 27

78 Ibid para 59

79 Ibid para 41

It was ruled that "in the light of the fact that the risk of non-recovery increases with the passing of time, the ability to spread payment of the tax owing before the capital gains are actually realised over a period of five years constitutes a satisfactory and proportionate measure for the attainment of the objective of preserving the balanced allocation of the power to impose taxes between Member States."[80]

The main issue that was confronted in the *DMC* case essentially centred on the question of whether Germany would actually lose all power to tax unrealised capital gains on an interest in a partnership when that interest is exchanged in return for shares in a capital company.

The German tax authorities assessed tax on the transfer based on the going concern value of the partnership interests, rather than the lower book value at which they had been transferred. German law provided for such an evaluation where Germany was not able to tax the unrealised gain. The referring German court indicated that because of the Austrian German tax treaty that was in force at the time, only Austria could tax the shares issued by the acquiring company.

Had the partners continued to be German taxpayers, the tax would only have been due when the shares in the acquiring company where disposed of. German law provided the option to pay the tax over a five year period subject to providing security.[81]

The Court ruled that Article 63 TFEU must be interpreted as meaning that the objective of preserving the balanced allocation of the power to impose taxes between Member States may justify the legislation of a Member State which requires assets in a limited partnership contributed to the capital of a capital company with its registered office in the territory of that Member State to be assessed at their value as part of a going concern. Thus, with the assets—before being actually realised—giving rise to the taxation of the capital gains relating to those assets generated in that territory, if it will in fact be impossible for that Member State to exercise its powers of taxation in relation to those gains when they are in fact realised, which is a matter for the national court to determine.[82]

In answering the second question, the Court went on to give an assessment of the risk, ruling that, by giving the taxpayer the choice between immediate recovery or recovery spread over a period of five years, as German legislation did, the legislation at issue in the main action does not go beyond what is necessary to

80 Ibid para 62

81 KPMG, 'E-news from the EU Tax Centre issue 40' KPMG Tax centre, [2014] p 2

82 *DMC* C-164/12 para 58

attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States.[83]

Therefore, the Court went on to rule that the answer to the second question was that that the national legislation of a Member State which provides for the immediate taxation of unrealised capital gains generated in its territory does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States, provided that, where the taxable person elects for deferred payment, the requirement to provide a bank guarantee is imposed on the basis of the actual risk of non-recovery of the tax.[84]

## Academic thoughts and opinions on the evolution and future of exit taxation in the EU

Exit taxation is by no means a stable area of taxation, especially in the age of globalisation. As with any constantly changing area of law, academic thought on the subject is varied and contentious, especially when analysed to determine whether it infringes upon the freedom of establishment and/or the movement of capital within the EU.

On one side of the debate, some academics have been motivated to begin questioning whether there is even a need for exit taxes at all, especially on unrealised capital, while on the other side is the argument that the exit tax regime is one which is relevant and necessary in an increasingly changing and challenging world.

This debate, however, is not confined to the realm of the EU. There is a healthy debate among scholars as to whether exit taxes on unrealised capital can be compatible with the principles of international law, such as those provided for in the International Covenant on Civil and Political Rights (Arts. 12 and 26); the Universal Declaration of Human Rights (Art. 13); and the Fourth Protocol to the European Convention on Human (Art. 2). Even though the right to emigrate is recognised as a fundamental human right, some States may impose limits on such right in well-defined circumstances, such as for the protection of national security and public order.[85]

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83 Ibid para 64

84 Ibid para 69

85 Fernando de Man and Tiiu Albin, "Contradicting Views of Exit Taxation under OECD MC and TFEU: Are Exit Taxes Still Allowed in Europe?" volume 39 [2011] Intertax, 615

Nevertheless, many of the criticisms from scholars of EU tax law naturally centre on the decisions of the CJEU and how they manifest themselves in practice. One example of this would be the thoughts condemning the *DMC* case as a step in the wrong direction for the understanding of exit taxation and that the CJEU is by no means a beacon of consistency. [86]

Yet there are other academics who have shown that the CJEU is very consistent and that the error in interpretation lies with the academics themselves.[87]

Yet one point on which there is consensus among academics is that for exit taxation to remain effective within the sphere of the EU and the EEA, there is a need for more possibilities to obtain certainty through the use of the exchange of information.

With regard to the mutual assistance directives, the conclusion is that guarantees can no longer be required, as these directives offer sufficient guarantees for tax authorities to monitor assets transferred abroad, unless guarantees are also demanded in domestic situations. In addition, charging late payment interest is only permissible if such interest is also charged in domestic situations.[88]

## Chapter 2

## South African Exit tax regime

### Overview of the evolution South African exit tax regime, including the legislation underpinning it and the historical reasoning for its implementation

The statues which govern exit tax in South Africa, are twofold; the first leg is found in the Currency and Exchanges Act Nº 9 of 1933 (The Act), which has its origins in the Principal Act from the Currency and Banking act Nº 31 of 1920, amended in 1923 and again in 1930. The Act was assented to on the 7th of March 1933.[89]

86 Barry Larkin, 'DMC: a step backward in understanding exit taxes?' KPMG EU Tax Centre [2014] page 3

87 T O'Shea, 'European Tax Controversies: A British – Dutch debate: Back to Basics and is the ECJ consistent?', World Tax Journal [2013]

88 Prof. Dr Hans van den Hurk, Dr Harm van den Broek and Jasper Korving, 'Final Settlement Taxes for Companies: Transfer of Seats, Interest Charges, Guarantees and Step-Ups in Value' Bulletin for International Taxation [2013] 257-267

89 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 13

The second leg is the statute called the Income Tax Act, Nº 58 of 1962, with the focus falling upon Section 9H, which was introduced by the 2012 Taxation Laws Amendment Act. Section 9H was introduced into the Act with effect from 1 April 2012 to consolidate the exit charge rules applicable when a person ceases to be a resident for South African tax purposes[90]

To start with the Act was introduced with the aim of amending South African law relating to legal tenders, currency, exchange and banking. It also deals with the system of exchange control.[91]

Exchange controls were applied more stringently during the apartheid era, especially in 1985 when international sanctions, trade boycotts, disinvestment campaigns and the withdrawal of loan funding to South Africa exerted severe pressure on the balance of payments and the domestic economy as a whole. At this time, any outward transfer was subject to prior approval by the exchange control authorities.[92]

The logic for having such a system in place lay in the view that the ability of the system to react quickly and without delay to changes in the International monetary system, which is achieved via the above structure of empowering an official to issue regulations, has been the central feature of the South African system since its inception in 1933. This feature is the essence of the system and is crucial to its effective functioning.

"The legislative component of the act doesn't contain any substantive rules regarding exchange control, but rather contains an empowering provision authorising an official to issue regulations which contain the applicable substantive rules relating to exchange control from time to time. This flexibility, and the ability to change the applicable exchange control regime very quickly, are deemed necessary in this particular sphere as South Africa can then adequately safeguard itself, its economy and the public against the vicissitudes of the dynamic world market".[93]

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90 Lavina Daya, 'Revised exit charge upon ceasing to be a resident in South Africa' Tax ENSight [2012]

91 *Shuttleworth v South African Reserve Bank and Others* para 14

92 Final Report of the Commission of Inquiry into the Rapid Depreciation of the Rand and Related Matters, 10th May 2002, page 50: <http://www.justice.gov.za/commissions/comm_rand/interim%20report_pdf.pdf>

93 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 12-14

A parallel currency called the financial rand was used exclusively for the movement of non-resident capital from June 1961 through to 1995 and was the product of the exchange controls then in place. Known as the "blocked rand" as it was available only to foreigners for investment in South Africa, the financial rand was created for the investment of non-residents' into assets in the country.

Essentially, this represented a discount to investors by offering them a preferential rate of exchange on foreign currency known as "the financial rand rate", for inbound investments, while investors would obtain the commercial rand rate on dividends, resulting in attractive profit margins. This two-tier currency system insulated the country's foreign reserves from politically motivated capital flight as all divestment was met with a heavy penalty at the commercial rand rate. The price of the financial rand varied independently of the commercial rand.[94]

The department of Financial Surveillance has the mandate for the day-to-day administration of exchange control in South Africa. Within the Financial Surveillance Department there is the Investigatory Division, which investigates alleged contraventions of the exchange control to recoup capital expense of the country's foreign currency reserves.[95]

The mandate that they have been given is to ensure the repatriation into the South African banking system of all foreign currency acquired by residents of South Africa, whether through transactions of a current or capital nature whilst preventing the loss of such foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa within the receipt of a commensurate consideration for the transfer of such assets. In addition, the mandate of the Investigatory division is to control and monitor in an effective manner the movement into and out of South Africa of financial assets, real assets/money and/or goods while at the same time not interfering unduly with the efficient operation of the commercial industrial financial systems of the country.[96]

The above mentioned mechanism is the over arching framework within which the exit tax regime of South Africa is required to operate within. However, despite the longevity of this system, recently there have been growing calls for reform.

Prior to 1994, South Africa was isolated internationally and this situation was mirrored in its tax regime, hence the lack of international tax case law. The strict

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94 André Roux, 'Everyone's Guide to the South African Economy', (Struik publishing 1996) p 124

95 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 18-19

96 Ibid para 21

regime of Exchange Controls existed, affording South Africans little opportunity to invest abroad. As a result, South Africa only needed to tax income arising within its geographical boundaries.[97]

Yet with the advent of the "new South Africa" and the ending of economic sanctions, the Financial Rand system was abolished on the 13th of March 1995. The same month, controls over the movement of capital owned by non-residents were repealed, although exchange controls on residents' capital account transactions was retained.

This need for reform was noted as South Africa emerged from the apartheid era after 1994. The Minister of Finance, Trevor Manuel, began moving towards the elimination of exchange controls to suit the prevailing economic conditions of the country. The sequencing for liberalisation of exchange control was categorised in six stages, the final one being to release emigrants' blocked funds. These related to capital funds and/or assets of emigrants to which restrictions had been applied in that the funds were not transferable from South Africa and were physically controlled by authorised dealers.

In his 2003 budget speech, Trevor Manuel announced that emigrants wishing to export more than R750,000 would need to apply to the Exchange Control Department to do so, subject to the submission of an exiting schedule and subject to payment of a charge equal to 10% of the amount sought to be exported.[98]

A person, including *inter alia*, a natural person, whether of South African or any other nationality, is considered a resident of South Africa for exchange control purposes once they have taken up residence or are domiciled or registered within South Africa.

Such individuals are then subject to South African exchange controls. If a person who is a South African resident for exchange control purposes leaves the Republic to take up permanent residence in any other country outside of the Common Monetary Area (CMA) OF South Africa, Namibia and the Kingdoms of Swaziland and Lesotho, he will be subject to the exchange control regulations.

An exchange control resident may remit the following funds abroad upon formal emigration from South Africa:

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97 The South African Tax Reform Experience Since 1994, Minister of Finance speech Trevor Manuel page 6 <http://www.treasury.gov.za/comm_media/speeches/2002/2002102501.pdf

98 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 25-27

- The unutilised foreign investment/capital allowance of up to R4 million per natural person over the age of 18 years, or up to R8 million for a family unit (being the once-off foreign investment/capital allowance).
- All other assets are subject to the payment of the 10% exit charge.[99]

In summary, on departure from South Africa, a resident is required to state full details of the nature and value of his assets, both in and outside South Africa, as well as similar information pertaining to any liabilities which will be outstanding in South Africa after his departure, to an Authorised Dealer of the South African Reserve Bank (SARB).The emigrant will also be required to obtain a tax clearance certificate from the South African Revenue Service (SARS).

The rules also state that once the person has emigrated, their South African assets become blocked. They can, however, on a separate application to SARB, request that these funds be remitted from South Africa against payment of the 10% exit charge.

Note should be taken of the fact that persons who have already emigrated but have not fully utilised the current foreign capital allowance (e.g. because it was less at the time of their emigration) are allowed to make additional capital transfers to the extent that the total amount remitted does not exceed the current limits set out above.[100]

To address some of the concerns about the impact of the exchange control regime, a so-called treasury management holding company regime was introduced on 27 February 2013 for the purposes of South Africa's foreign currency exchange controls (Exchange Control Circular 7/2013).

In terms thereof, companies listed on the Johannesburg Securities Exchange will be allowed to establish one subsidiary to manage the group treasury functions free from exchange controls in one foreign currency of choice.[101]

The above shows is that companies and the payments made to a foreign party are heavily governed by the exchange control rules which are already in place. Like private individuals, companies based in South Africa are required to provide a justification for making the transfer and can only make the transfer with the prior

99 tax ENSight 'Tax and exchange control implications of emigration' tax ENSight [2010]

100 Ibid

101 Johann Hattingh, 'South Africa - Corporate Taxation' IBDF [2014] 95

approval of the SARB or the authorised dealer. The exchange control rules govern all foreign payments and investments made by a company in South Africa as well as any loan granted by a foreign investor to a resident of South Africa.

Paragraph 12 of the Income Tax Act Nº 58 of 1962 it sets out that "when a person ceases to be tax resident in South Africa, all the assets of the person are deemed to be disposed of, except assets comprising the person's South African permanent establishment, and immovable property situated in South Africa. The effect is that a capital gain or loss will have to be determined for all the assets (other than fixed property in South Africa and assets of a permanent establishment) wherever such assets are situated."

If gains exceed losses, tax will be payable on the taxable capital gain. This process effectively functions as an exit tax from South Africa.[102]

The 2012 Taxation Laws Amendment Act introduced section 9H to the Income Tax Act Nº 58 of 1962, which has gone further by providing for a single set of company-level tax to be triggered when a company ceases to be a South African tax resident by virtue of a change in effective management (the section also applies to a company becoming a headquarter company). Section 9H applies to a person or company that ceases to be a resident, or a company which becomes a headquarter company and a controlled foreign company that ceases to be a controlled foreign company, subject to limited exclusions.

In the example of a resident company which ceases to be a resident or becomes a headquarter company, it will be deemed to have distributed its assets as a dividend in specie in accordance with each shareholder's effective interest.

The company will therefore potentially be liable for dividends tax, depending on the availability of any dividends tax exemptions. The amount of the deemed dividend is deemed to be the market value of the shares in the company (i.e. the company's gross value net of liabilities) less the sum of contributed tax capital.
Section 9H will not apply in respect of a company that ceases to be a resident as a result of an "amalgamation transaction" or a "liquidation distribution".[103]

102 Lavina Daya, 'Revised exit charge upon ceasing to be a resident in South Africa' Tax ENSight [2012]

103 ibid

## Case law analysis showing the challenges to the current regime

Two prominent recent cases demonstrate the struggle which South Africa faces in its exit tax regime, especially in trying to reconcile the need for reform with its ambitions to become a favourable international trading partner.

The first case involves the billionaire Mark Shuttleworth and his decision to disinvest from South Africa, which was due to the restrictions placed on capital movements as it created problems for Shuttleworth's international operations. This quickly prompted him to take advantage of his dual citizenship and emigrate from the land where he got his start to The UK, where he settled on the Isle of Man.[104]

By disinvesting his assets from South Africa before emigrating, the remaining assets located in South Africa were subsequently blocked. In order to remit the funds from South Africa, Shuttleworth was required to pay a 10% levy to the South African Reserve Bank.

The legal challenge brought by Mark Shuttleworth is recorded in the case of *MR Shuttleworth v South African Reserve Bank and Others*[105]. The argument put forward in the case shows that the claimant was seeking a declaration that the imposition of the 10% levy would be invalid and to declare section 9 of the Currency and Exchanges Act Nº 9 of 1933, which deals with *Regulations regarding currency banking or the exchanges*[106], invalid by reason that it is inconsistent with section 195 of the South African Constitution.[107]

The Court summarised the appellant's argument into three sections: First, the fundamental predicament; second, no law of general application; and finally the rigid and inflexible application of the policy.[108]

The first argument which was put forward related to procedural failure. In essence, it was argued that the levy was calculated in order to raise revenue and that the provisions of section 9(4) of the Act had not been complied with; however, the Court pointed out that the heading of restrictions for Capital exports is calculated to 'restrict export of capital' and not seek profit. It also went on to argue that it is clear that the imposition of the 10% levy was directed at those who

104 Richard Grant, 'Cost Mark Shuttleworth more to leave South Africa than to go to space.' <http://www.forbes.com/sites/richardgrant/2013/08/25/> Accessed 30 May 2014

105 Case No 307 09/210, North Gauteng High Court

106 Currency and Exchanges Act no. 9 of 1933

107 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 1 - 11

108 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) 54

had accumulated considerable wealth in the Republic so that when they wished to disengage from the Republic, it was intended that they would incur the 10% levy as a form of discouragement. The idea of such discouragement cannot be said to be an unfair nor unconstitutional policy.[109]

Secondly, the Court went on to find that the regulation under which the levy was imposed was directed primarily towards restricting exports of capital and not towards raising revenue. The court agreed with SARB's analogy that "you cannot say you are raising revenue when you are fined for speeding". Put simply, when speeding is made an offence, that prohibition is not intended to raise revenue. The prohibition is intended to ensure that we do not have unnecessary fatalities on our roads. But those who offend are punished by, for example, paying fines. Despite the fact that revenue might be generated by the levy, it was imposed primarily to deter persons from exporting capital and not as a means of raising revenue for the State. It is the purpose of the regulation and not the application of the amounts that may arise that was critical to the inquiry.[110]

The second challenge related to the lack of statutory guidelines in the regulations to direct how applications of this kind should be determined. The argument was that the regulations make no provision for the power to grant permissions and exceptions, which is given to the Minister of Treasury and delegated to the Reserve Bank, to be exercised in accordance with the requirements of procedural fairness.

It had been held in earlier proceedings before the Constitutional Court that a lack of guidelines relating to the exercise of discretion may be offensive to the Constitution.[111] However, the Court analysed these judgments and concluded that the requirement to provide guidelines was dependent on the facts of each case.[112]
The court concluded that exchange control requires a flexible, speedy and expert approach to ensure proper financial governance. The variety of circumstances which may arise influences against laying down rules or factors in advance hence the need for flexibility, the responsibility having been delegated to SARB and then, under the auspices of SARB, to authorised dealers with the requisite experience and expertise to analyse applications and apply their discretion appropriately without the need for guidelines. Thus, a failure to specify guidelines in these circumstances was deemed justifiable.[113]

109 Ibid para 114

110 Ibid para 63- 69

111 Ibid para 133

112 Ibid para 80

113 *Shuttleworth v South African Reserve Bank and Others* [2013] 3 All SA 625 (GNP) para 81 -83

The third element was that there had been no consultation on the measure and that this is required in terms of the Constitutional framework for legislation.

This argument relied on it being held that the power to impose the levy was founded in the circulars or rulings of SARB. Shuttleworth argued that the system of exchange controls in South Africa is not governed by laws, but by the dictates of an organ of state the Reserve Bank, a situation which violates a basic principle of parliamentary democracy, namely that there should be no taxation without representation, and that the executive branch of government should not be able to raise revenue in the form of levies without Parliament's direct consent.

This, the Court rejected. The power to impose the levy was founded on the Minister's decision as announced on 26 February 2003. The application did not seek to declare the Minister's decision invalid.[114]

The Court found that SARB had discretion to grant permission to export funds, but once it had done so it had no discretion whether or not to impose the 10% levy. The levy was mandatory as decreed by the Finance Minister.[115]

The decision also looked at the accusation that the applicant had not been given the opportunity to be heard on his submission that the 10% levy was unlawful, due partially to the "closed door policy" of exchange control by which all applications are filtered through an authorised dealer, and to the fact that the application form FA1 did not contain a reference to the levy.

The Court further found that the applicant had previously been subjected to the levy and was therefore fully aware of it. Furthermore, he had been given the opportunity to make submissions in respect of the levy when SARB accepted and deliberated on the resubmitted application. The process was therefore considered not to have been procedurally unfair.[116]

Perhaps the best opportunity to summarise the Court's perspective arose when it posed the rhetorical question of what will happen to South Africa if all of the wealthiest men and women in the country were allowed to transfer their financial assets out of the country with impunity every time the country experienced economic turmoil or when the government or leaders changed. This could have a devastating effect on the country as a whole by devaluing the economy.[117]

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114 Ibid para 95

115 Ibid para 68

116 Ibid para

117 Ibid para 114

The second case which is vital to understanding the South African exit tax regime is *Commissioner for the South African Revenue Service v Tradehold Limited*[118].

What makes this case so important is that it shows how the exit tax regime operates and how exit tax is understood in terms of companies operating at international level.

Tradehold is an investment holding company incorporated in South Africa and listed on the Johannesburg Stock Exchange. On 2 July 2002, Tradehold's board of directors resolved that all further board meetings would be held in Luxembourg. The resolution reached was effective from 2 July 2002, at which point the company became managed in Luxembourg.

The background to this case was that in 2000 a double tax agreement (DTA) between South Africa and Luxembourg was entered into. It was deemed that under of Art. 4(3) of the DTA, 'Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.'[119]

However, Tradehold remained a resident of South Africa by reason of its incorporation in the Republic as provided by section 1 of the Income Tax Act N° 58 of 1962 (The Act) at that time.

The term 'resident' was defined in the Act in relation to a person (other than natural person) who is incorporated, established or formed or has its place of effective management in the Republic.[120]

The rational of this definition is that a taxpayer, who ceases to be tax resident in South Africa, is deemed to have disposed of all of its assets at market value immediately prior to such cessation. This effectively realises all capital gains which have accrued to the taxpayer while it was tax resident in South Africa.

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118 (132/11) (2012) ZASCA 61

119 Convention between the Republic of South Africa and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (23 Nov. 1998), Treaties IBFD

120 Subparagraph (1) applies, in the case of-(a) a person who ceases to be a resident, or a resident who is as a result of the application of any agreement entered into by the Republic for the avoidance of double taxation treated as not being a resident, in respect of all assets of that person other than assets in the Republic listed in paragraph 2(1)(b)(i) and (ii);(b) an asset of a person who is not a resident, which asset-(i) becomes an asset of that person's permanent establishment in the Republic otherwise than by way of acquisition; or(ii) ceases to be an asset of that person's permanent establishment in the Republic otherwise than by way of disposal contemplated in paragraph 11"

Using this rational the South African Revenue Service (SARS) sought to levy the exit charge in respect of a share disposal in a subsidiary company. Relying on the provisions of para 12 of the Eighth Schedule to the Act, the Commissioner contended that when the respondent relocated its seat of effective management to Luxembourg on 2 July 2002, or when it ceased to be a resident of the Republic on 26 February 2003, it was deemed to have disposed of its only relevant asset, the shares it held.

Tradehold argued that it was not subject to the exit charge levied, as the DTA states that capital gains from the alienation of property are taxable only in the country of which the alienator is tax resident. For purposes of the DTA, Tradehold had been tax resident in Luxembourg since 2002, when it moved its place of effective management.[121]

SARS's argument was that the DTA provided no relief from the taxation of the gain in South Africa as the alienation of property referred to in Article 13(4) of the DTA did not include deemed disposals in terms of paragraph 12 of the Eighth Schedule of the Act. The basis of the Commissioner's argument was that Article 13 could not apply as an alienation refers to an actual or real disposal while a deemed disposal is a fictional disposal.[122]

SARS went on to argue that on 26 February 2003, the definition of 'resident' in the South African Income Tax Act was changed to make it clear that it excludes taxpayers deemed to be exclusively residents of other countries for the purposes of double taxation agreements (i.e. treaties which determine taxing rights between countries so that countries may not subject a taxpayer to tax on the same amount). As the South Africa-Luxembourg treaty deems taxpayers effectively managed in Luxembourg to be Luxembourg tax residents, the taxpayer ceased to be a South African resident for domestic tax purposes as of 26 February 2003.[123]

The loss of domestic residence was, SARS alleged, the trigger for the aforementioned exit taxes.

The question that the Court stated was vital was whether the term 'alienation' as used in the DTA includes within its ambit gains arising from a deemed (as opposed to actual) disposal of assets.

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121 Commissioner for the South African Revenue Service v Tradehold Limited (132/11) (2012) para 8

122 Ibid para 4

123 Ibid para 3

The Court also noted that once brought into operation a double tax agreement has the effect of law. Its legal effect was described by Corbett JA in *SIR v Downing* 1975 (4) SA 518 (A) at 523A:'[A]s long as the convention is in operation, its provisions, so far as they relate to immunity, exemption or relief in respect of income tax in the Republic, have effect as if enacted in Act 58 of 1962 (see s 108(2)).'[124]

Article 13 is widely cast. It includes within its ambit capital gains derived from the alienation of all property. It is of significance that no distinction is drawn in Art. 13(4) between capital gains that arise from actual or deemed alienations of property there is moreover no reason in principle why the parties to the DTA would have intended that Art. 13 should apply only to taxes on actual capital gains resulting from actual alienations of property.

In passing judgement, the Court ruled that a deemed disposal of property should not be treated any differently from an actual disposal of property for tax treaty purposes. The term 'alienation' in the treaty was neutral and could refer to both actual and deemed disposals that gave rise to capital gains.[125]

From 2 July 2002 then, the South Africa-Luxembourg treaty became applicable to the taxpayer and Luxembourg had exclusive taxing rights over all the taxpayer's capital gains, therefore the Court rejected the case of SARS based on the above rationale.

## Academic thoughts and opinions on the South African approach to exit taxation

The current exit tax regime in South Africa is undoubtedly antiquated and reform has been discussed, as evidenced by the Government's search for ideas.

South Africa is a society which is still developing and although it has been twenty years since full democracy was established, it is still shaking off the dust of the past. This rings true when one considers the current state of thought, or lack thereof, among tax academics.

Nevertheless, academic thought is mixed on the implementation of exit tax and the exchange control system. Some frustration is directed at the lack of progress in the exit tax field, while the government drags its feet on potential reforms. Despite the judicial thought expressed in the Mark Shuttleworth case to the contrary, some

124 Ibid para 16

125 Ibid para 24-25

academics are asking whether the whole regime and the manner in which it is applied comprises a breach of constitutional and international law.

The circumstances set out in the current and proposed legislation give rise to an encroachment; first, it breaches Article 13 of the Universal Declaration of Human Rights and secondly the fundamental constitutional rights of taxpayers, which can only be encroached upon if properly justifiable in terms of section 36 of the Constitution of South Africa[126], which would entail the onus being placed upon taxpayers under strict scrutiny to justify such an encroachment.

The state would have to demonstrate that the encroachment is a law of general application and reasonable and justifiable in an open and democratic society.[127]

Yet other academics and tax professionals have pointed out that the Court had erred in its interpretation of the Tradehold case and that the defendants were fortunate to obtain the result that they did. If the DTA had wanted to treat actual alienations of property in the same manner as deemed alienations of property then it would have explicitly said so.[128]

This thought ignores the explanation given by the Court in paragraph 17-19, whereby the role and application of the OECD model tax convention is explained in international tax was explained, thus demonstrating a lack of understanding.

The Mark Shuttleworth case triggered a massive debate within South Africa as it was the first time that the exchange controls regime was so publicly challenged.

Some argued that the State is bluffing if it thinks that it can protect society against "the vicissitudes of the dynamic world market." The contemporary global market is a very different one to that which existed in 1933 or 1961.

In recent years it has been clearly demonstrated that events with transnational influence such as the emergence of the financial crisis in the US towards the end of 2008 and the April 2010 eruption of the Icelandic volcano Eyjafjallajökull, have the potential to exert a startling and immediate influence over economic activity at global level and which, crucially governments and policy makers have very little power of control over.

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126 Chapter two, Bill of rights, 'South African Constitution' <http://bill-rights-chapter-2-constitution-republic-south-africa> Accessed 23rd May 2014

127 Prof Daniel N Erasmus, 'Letter to SA Treasury on SA Exit Tax', <http://www.erasmusontax.com/letter-to-sa-treasury-on-constitutionality-of-sa-exit-tax> Accessed 1st August 2014

128 Barry Ger, 'Parting shots, Exit tax successfully challenged in new case', De Rebus [2011] 51-51

The attitude which is prevalent among many in South Africa can perhaps be expressed and paraphrased as “give us the freedom to take and invest our money where we want; we will take our chances in the global economy; spend your energy instead on creating an economic environment in our own country which will encourage us and foreign investors to retain our money in this country”.[129]

Others, including the Court itself, point out that some aspects of the era of exchange controls which came into effect in 1933 are unconstitutional. It is clear that certain regulations governing exchange controls have been found wanting and that sections of the Currency and Exchanges Act must be refined in order to comply with the Constitution.[130]

Examples of this anomaly are found in Section 9(3) of the Constitution, which not only gives the President power to amend or suspend any part of the Currency and Exchanges Act, but also the power to amend or suspend any Act of Parliament.[131]

The most telling aspect is how the South African authorities have reacted when challenged. It is this reactionary mentality and approach which is likely to prove the greatest obstacle to reform.

In the Tradehold case, for instance, it was been pointed out that the response of SARS was overly vigorous. The revenue authorities reacted almost immediately to the decision. On the day following the judgment, a media statement was released which claimed that the ruling “that a double taxation agreement applied to a deemed disposal and thus did not allow for an exit charge” had “disturbed the balance that has been achieved”.

The Draft Taxation Laws Amendment Bill which was released in July 2012 proposed new measures to bolster and extend exit taxes. It has been proposed that from 8 May 2012, any persons that change tax residence will be deemed to end their tax year on the day before they become resident of the foreign country. This is to ensure that they cannot rely on tax treaties to escape exit taxes.

In addition to the CGT charge, companies leaving South Africa will also be liable for dividends. Upon departure, they will be deemed to have distributed their assets to shareholders and thus will be levied with an extra 15% tax on the value of those

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129 Ben Strauss, ‘The pillars of the exchange control temple crumbling?’, DLA Cliffe Dekker Hofmeyr Tax Alert [2013] 2

130 Dr Beric Croome, ‘Exchange Control and the Shuttleworth Decision’, accessed 5th May: 2014 <http://www.bericcroome.com/2013/10/exchange-control-and-shuttleworth.html>

131 Nyasha Musviba, ‘Shuttleworth wins some, loses some in court’, accessed 23rd April 2014: http://sataxguide.wordpress.com/2013/07/19/shuttleworth-wins-some-loses-some-in-court/

assets. This is similar to the 10% Secondary Tax on Companies which was previously imposed prior to 1 April 2012 when companies changed their South African residence. [132]

In response to the Mark Shuttleworth case, the authorities have issued outlandish statements such as "the order sought by Shuttleworth in the North Gauteng High Court in Pretoria was the most radical court order imaginable and had the potential to ruin South Africa".[133]

In response to the claim that the whole system is wrong and it would be in the best interests of all South Africans to abolish it, one commentator noted "[Shuttleworth] couldn't get his money out of the country. Now he wants to pull the whole system down.

Why should this financial refugee, living on the Isle of Man, speak on behalf of the entirety of South African society?"[134]

## Conclusion

The position in which South Africa finds itself is at once enviable and precarious. Enviable as it has seen its entire legal and social structure reset by the imposition of democratic values, which suggests that it should be able to learn from the past. Precarious as the longer the delay, the more the economy will be restrained having placed part of its revenue structure on antiquated laws and restlessness among the populace, where the current unemployment rate of 40% will inevitably rise.

Upon reflection, the lessons that South Africa would do well to learn from the EU is by looking at how the concept of deferral, especially in light of the *Commission v Denmark*[135], *National Grid Indus*[136] and *DMC*[137] is implemented, works and is understood, as well as how the balance between the exit tax regime and business needs are understood and implemented, be it from an academic or legal viewpoint.

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132 Barry Ger, 'SARS Overreacts After SCA Decision On Exit Taxes' SAIT [2012]

133 Enerst Mabuza, 'Difficult to imagine' currency act is unconstitutional', accessed 1st July 2014: <http://www.bdlive.co.za/business/2013/06/12/difficult-to-imagine-currency-act-is-unconstitutional>

134 Finance 24, ' Shuttleworth bid South Africa could face ruin', accessed 23rd July 2014 <http://www.fin24.com/Economy/Shuttleworth-bid-SA-could-face-ruin-20130611>

135 C-261/11

136 C-371/10

137 C-164/12

As shown above, the unhelpful comments made by SARS give impetus to the need for change, as they seem only to willing to compound the problem.

Exit tax provisions would need to be amended to incorporate an option for taxpayers to be required to pay exit tax only in cases of actual realised gain, subject to some form of security being given by the taxpayer.

The principles applied in these judgements give rise to an analogous position in South Africa when one considers the transgression of fundamental rights in the Constitution of South Africa. South Africa has already accepted and implemented the deferral option in respect of immovable property and assets attached to permanent establishments.[138]

The argument of whether money which SARS is entitled to tax once it has left South African shores can never be recovered, so-called "capital flight" is a misnomer and indeed baffling, especially in light of recent case law and statute that has been passed. Firstly, the 21st February 2014 saw the Convention on Mutual Administrative Assistance in Tax Matters passed in South Africa, the purpose of which is to increase the cooperation amongst 64 tax authorities around the world and to combat tax avoidance and evasion at international level and in the obtaining of information with a view to assessing residents correctly for taxation purposes.[139]

Secondly the UK case of *Revenue and Customs & Another v Ben Nevis (Holdings) Ltd & Others*[140] saw international cooperation between HMRC and SARS in action and this turned out to be a resounding success for SARS in terms of recouping funds owed. Therefore in light of the assertion used when the Court ruled that allowing people to move their money would have a devastating effect on the South African economy, potentially ruining it, is not entirely true as a framework is already in place to combat any abuses.

Lastly, there is also a tax treaty network involving over one hundred and twenty countries already in place. Unlike in the past when South Africa faced international isolation, the relationships it has recently established with various countries make it illogical to cling to a statute which was deemed necessary when the country was a pariah State.[141]

138 Prof Daniel N Erasmus, 'Letter to SA Treasury on SA Exit Tax', accessed 1st August 2014: http://www.erasmusontax.com/letter-to-sa-treasury-on-constitutionality-of-sa-exit-tax

139 Dr Beric Croome, 'Nowhere to hide' Tax ENSight [2014]

140 [2012] EWHC 1807

141 SARS, 'Double Taxation Agreements (DTA)and protocols', accessed 23rd July 2014: http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx

Perhaps the most important lesson South Africa has to learn is that having a draconian exit tax regime tarnishes its image and economic standing on the world stage. Especially as once one has invested in South Africa, extricating oneself could prove very costly and complex.

These thoughts have also filtered down to the business community, with the most prevalent question being asked: “why do we have this system in place in the modern age?” The point has been made that the capital-flight argument and the hysteria of the authorities is absurd. Of the world’s 200 countries without “capital flight”, only 35 have exchange controls.

Effectively, South Africa and a handful of others are telling the world: “Don’t invest here. We have no confidence in ourselves.”[142] Given the fundamental nature of the global economy and the benefits it presents to investors in terms of their ability to pick and choose where they invest their funds, it is clear that this message is ultimately self-defeating and needs to change, or South Africa will continue to spiral into a more precarious position.

142 Leon Louw, ‘Exchange controls send wrong signal to investors’, accessed 20 June 2014: <http://www.bdlive.co.za/opinion/columnists/2013/06/19/exchange-controls-send-wrong-signal-to-investor>