

DRAFT INTERPRETATION NOTE: NO. 34 (Issue 2)

DATE:

ACT : INCOME TAX ACT NO. 58 OF 1962
SECTION : SECTION 10(1)(o)(i)
SUBJECT : EXEMPTION FROM INCOME TAX: REMUNERATION DERIVED BY A PERSON AS AN OFFICER OR CREW MEMBER OF A SHIP

Preamble

In this Note unless the context indicates otherwise –

- “**Republic**” and “**South Africa**” are used interchangeably as a reference to the sovereign territory of the Republic of South Africa, as defined in the definition of “**Republic**” in section 1(1);
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act No. 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance on the circumstances under which section 10(1)(o)(i) exempts the remuneration derived by a person as an officer or crew member of a ship from normal tax.

2. Background

Section 10(1)(o)(i) was inserted into the Act in 1993, to bring the provisions of the Act in line with that of other major maritime nations, which exempt certain seafarers from normal tax if they are absent from their home countries for a period or periods exceeding 183 days in aggregate during the year of assessment.

In 2007, the definition of “**Republic**” in section 1(1) was amended, and the effect of that amendment is discussed in this Note. The impact of any agreement for the avoidance of double taxation is not discussed, as the terms of such agreements vary from treaty to treaty.

3. The law

The relevant provisions of the Act are quoted in the **Annexure**.

4. Section 10(1)(o)(i) analysis

4.1 Remuneration

Section 10(1)(o)(i) exempts any form of remuneration that is derived by a person as an officer or crew member of a ship. The remuneration that qualifies for exemption is wide, being any “remuneration”¹ as defined in paragraph 1 of the Fourth Schedule.

The word “derived” is not defined in the Act. In *Port Elizabeth Municipality v Union Government (Minister of Railways and Harbours)*² Innes CJ said the following regarding the use of the word “derived” in the Cape Municipal Ordinance, 10 of 1912:

“The expression ‘from which revenue is derived’ does not present much difficulty. In *Commissioner of Taxes v Kirk* (1900 AC 588) the question arose whether certain income was ‘derived from lands of the Crown held under lease,’ and in the judgment of the Privy Council it was remarked that ‘their Lordships attach no special meaning to the word “derived” which they treat as synonymous with arising or accruing.’ To fall within the language of the proviso the revenue must flow or accrue directly from the building. The income of a trading business is not derived from the shop in which it is carried on, but from the sales there transacted. If, however, a charge were made for storing goods in the shop, the revenue thus accruing would be derived from the building – for it would flow directly from its use.”

(Emphasis added.)

In context, this means that there must be a causal connection between the remuneration received, and the person’s role as an officer or crew member on the ship, in order for the exemption to apply. Any remuneration derived outside the Republic other than as an officer or crew member of a ship, does not qualify for exemption under this provision.

The remuneration that is covered by the exemption relates only to remuneration derived by a person during a year of assessment,³ even though the officer or crew member may have started service outside South Africa before the year of assessment commenced or ended service outside South Africa after the year of assessment terminated.

Example 1 – Exemption of remuneration earned during year of assessment

Facts:

B, who is ordinarily resident in South Africa, accepts a contract to render services on board a cruise liner which is involved in the transportation of passengers in international waters (outside the Republic). B left on board the cruise liner on 1 January 2015 and returned to South Africa on 30 September 2015. During this time, B derived remuneration of R40 000 per month. From 1 November 2015 to 28 February 2016, B earned remuneration of R35 000 per month from a casino within South Africa.

¹ Refer to the **Annexure** for the definition of “remuneration”.

² 1918 AD 237.

³ As defined in section 1(1).

Result:

B meets the requirements of section 10(1)(o)(i)(aa). B is a crew member on board a ship that is engaged in the international transportation for reward of passengers (see below for a full discussion of all of the requirements). B is outside South Africa for more than 183 full days in aggregate during the 2016 year of assessment. The remuneration derived as a crew member on board the ship will be exempt from normal tax. During the 2016 year of assessment, B's remuneration of R40 000 per month from March 2015 to September 2015, that is, R280 000 (R40 000 × 7) is exempt.

B's remuneration earned aboard the ship during the 2015 year of assessment (R40 000 per month for each of January and February 2015, that is, R80 000) does not qualify for exemption as it was not derived during the same year of assessment that B was outside the Republic for more than 183 days. B was not outside the Republic for more than 183 days during the 2015 year of assessment.

The remuneration earned from the South African casino also does not qualify for exemption as it was not derived as an officer or crew member aboard a ship.

4.2 Any person as an officer or crew member

The exemption under section 10(1)(o)(i) applies to "any person" but practically can mean only individuals who are South African residents. Remuneration received by or accruing to a non-resident for services rendered outside South Africa is not from a South African source and therefore not subject to normal tax in South Africa. A "resident" as defined in section 1(1) is subject to tax on worldwide income in terms of the definition of "gross income" in section 1(1). Persons other than residents (non-residents) are subject to tax only on income from a South African source.⁴

The person must be an officer or crew member aboard the ship. Income earned by passengers or business persons (for example, owners of concessionary shops or restaurants on a cruise ship) whilst aboard the ship does not qualify for exemption under section 10(1)(o)(i).

The person must be an employee in order to qualify for the exemption. A person cannot be an officer or crew member aboard a ship without also being an employee.⁵

⁴ See Interpretation Note No. 3 dated 4 February 2002 "Resident: Definition in Relation to a Natural Person – Ordinarily Resident" and Interpretation Note No. 4 (Issue 4) dated 12 March 2014 "Resident: Definition in Relation to a Natural Person – Physical Presence Test" for more information on what constitutes a "resident" under the Act.

⁵ That this is the case is clear from the provisions of the Merchant Shipping Act No. 57 of 1951. For more information on employees and independent contractors, see Interpretation Note No. 17 (Issue 3) dated 31 March 2010 "Employees' Tax: Independent Contractors".

4.3 Qualifying ships

4.3.1 Ships engaged in international transportation

The exemption⁶ applies if the ship is engaged in the international transportation of passengers or goods for reward.⁷ This refers to merchant ships such as cruise ships, passenger liners and cargo ships travelling in international waters (see 4.4).

The transportation must be for reward, otherwise the exemption will not apply. The requirement that the ship must be engaged in the business of transportation means that, for example, the transport of fish from the fishing ground to the port by a trawler will not constitute transportation “for reward” because the trawler is in the business of fishing and not transportation.

4.3.2 Ships engaged in prospecting, exploration, mining or production

The exemption⁸ also applies if the ship is engaged in the prospecting, exploration or mining (including surveys and other work of a similar nature) for any minerals (including natural oils) or the production of any minerals (including natural oils) from the seabed outside South Africa.

The exemption under section 10(1)(o)(i)(bb) applies to officers and crew members who are employed on a ship solely for purposes of the passage⁹ of such ship. The word “passage” in this context simply means the navigation of the ship in a continuous, speedy and efficient manner. The exemption will therefore not apply to officers or crew members involved in the prospecting, exploration, mining or production activities of the ship. Only the remuneration of those officers and crew members involved in navigating the ship may qualify for exemption.

Officers and crew members employed for purposes other than the navigation of a ship may still qualify for exemption of their earnings under section 10(1)(o)(ii), provided the relevant requirements of that section are met.¹⁰

Example 2 – Aboard the ship for purpose of passage

Facts:

Z works aboard a South African marine mining vessel which is involved in exploring for natural oils in the seabed under the high seas. As a geologist aboard the ship, Z is a crew member involved in the ship’s mining activities. During the 2016 year of assessment, Z was outside South Africa for 185 full days.

⁶ Under section 10(1)(o)(i)(aa).

⁷ The phrase “for reward” refers to compensation received for the transportation of the passengers or goods on the ship.

⁸ Under section 10(1)(o)(i)(bb).

⁹ As defined in section 1 of the Marine Traffic Act No. 2 of 1981.

¹⁰ See Interpretation Note No. 16 (Issue 2) published as a draft on 26 February 2016 “Exemption from Income Tax: Foreign Employment Income” for more information.

Result:

Despite Z being outside South Africa for more than 183 full days, the requirements of section 10(1)(o)(i)(bb) are not met: the exemption applies only in respect of officers or crew members employed *solely for purposes of the “passage” of the ship*. Z is not involved in the passage of the ship, but with the exploration activities of the ship.

Z may qualify for exemption under section 10(1)(o)(ii), provided that all of the requirements for that exemption have been met.

4.4 Outside the Republic

In order to qualify for exemption, the officer or crew member must be “outside the Republic”. The “Republic” is defined in section 1(1).¹¹ The definition encompasses the landmass of South Africa as well as its territorial waters,¹² which is a belt of sea adjacent to the landmass but not exceeding 12 nautical miles (roughly 22,2km) beyond the baselines¹³ of the country.

In certain circumstances, the Republic may extend beyond the geographical limits of its landmass and territorial waters. The definition of the “Republic” specifically includes those areas beyond the territorial sea which have been designated under international or domestic law as areas where South Africa may exercise sovereign rights in respect of the exploration or exploitation of natural resources. This definition is aligned with domestic law¹⁴ and international law,¹⁵ which provide for South Africa’s right to explore and exploit natural resources in the exclusive economic zone (EEZ)¹⁶ and on the continental shelf.¹⁷

¹¹ “[T]he Republic of South Africa and, when used in a geographical sense, includes the territorial sea thereof as well as any area outside the territorial sea which has been or may be designated, under international law and the laws of South Africa, as areas within which South Africa may exercise sovereign rights or jurisdiction with regard to the exploration or exploitation of natural resources.”

¹² Defined in section 4 of the Maritime Zones Act No. 15 of 1994 (MZA). This definition is aligned with what constitutes a state’s territorial sea under international law, specifically Articles 2 and 3 of the United Nations Convention on the Law of the Sea (UNCLOS), signed by South Africa on 5 December 1984 and ratified on 23 December 1997.

¹³ Defined in section 2 of the MZA and Article 3 of UNCLOS.

¹⁴ Section 7 of the MZA.

¹⁵ Section 233 of the Constitution of South Africa, 1996 provides that a court must prefer an interpretation of domestic legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.

¹⁶ Article 56(1)(a) of UNCLOS deals with a state’s “exclusive economic zone” and provides that a coastal state has “...sovereign rights for the purpose of exploring and exploiting...the natural resources, whether living or non-living, of the waters superadjacent to the seabed and of the seabed and its subsoil...”

¹⁷ Article 77(1) of UNCLOS provides that a “...coastal State exercises over the continental shelf sovereign rights for the purpose of exploring it and exploiting its natural resources.” In view of this provision, it is unnecessary to consider for purposes of this Note whether the continental shelf forms part of South Africa’s territory under customary international law.

The EEZ extends to 200 nautical miles (roughly 370,6km) from the baselines.¹⁸ The continental shelf extends to the outer edge of the continental margin, or 200 nautical miles from the baselines, whichever is the greater.¹⁹

The effect of the extended meaning of the “Republic”, as set out above, is that “outside the Republic” has differing meanings under items (aa) and (bb) of section 10(1)(o)(i).

Item (aa)

Under item (aa), an officer or crew member aboard a ship transporting goods or passengers for reward, will be outside the Republic if that person is **outside the territorial waters** of South Africa. The extended definition of the “Republic” does not apply, because the ship is not involved in the exploration or exploitation of natural resources.

Example 3 – Outside the Republic

Facts:

M, who is ordinarily resident in South Africa, is employed by XYZ Shipping, a cargo shipping company. The ship, on which M is an officer, is involved in the transportation of goods to the Far East for reward. M left the port of East London and South African territorial waters on 20 March 2015 on a trip to India and China, and arrived back in South African waters on 20 December 2015. M was paid a salary of R420 000 for services on the ship during that period.

Result:

M is not liable for South African normal tax for the 2016 year of assessment on the R420 000 remuneration derived as an officer on the ship, as M was outside the territorial waters of South Africa for more than 183 full days in aggregate during the year of assessment (21 March 2015 to 19 December 2015 is 274 full days). M meets the requirements of section 10(1)(o)(i)(aa) and the remuneration derived is therefore exempt.

Example 4 – Outside the Republic

Facts:

S, who is ordinarily resident in South Africa, is employed by PQR Cruise Ship, a cruise liner that undertakes pleasure cruises around Southern Africa. S is a deckhand and thus part of the crew of the ship, which as a cruise liner is involved in transportation of passengers for reward.

¹⁸ Section 7 of the MZA and Article 57 of UNCLOS.

¹⁹ Section 8 of the MZA and Article 76(1) of UNCLOS.

During the 2016 year of assessment, S rendered services for 244 days aboard the ship whilst it was cruising in the EEZ and the high seas of the Indian Ocean, that is, outside of South Africa's territorial waters, and 62 days while the ship was within South African territorial waters and ports. The remaining 60 days of the year, S was on shore leave in South Africa. S earned remuneration of R210 000 during the year of assessment for services as a deckhand.

Result:

S is not liable for South African normal tax for the 2016 year of assessment on the remuneration of R210 000 derived as a deckhand on the ship. S rendered services as a crew member aboard the ship in the EEZ and on the high seas for 244 days, and was thus outside the Republic for more than 183 days in the year of assessment. Even though some of the services were rendered within South Africa, all of the remuneration derived as a crew member falls to be exempted under section 10(1)(o)(i) (see **4.5**).

Item (bb)

For purposes of subparagraph (*bb*), resident officers or crew members navigating a ship that is engaged in prospecting, exploration, mining or production of or for minerals in the seabed are outside the Republic when they are ***beyond the edge of the continental shelf*** of South Africa.

4.5 Days test

In order to qualify for the exemption, a person must be outside the Republic for at least 183 full days during the year of assessment. A "full day" means 24 hours (from 0h00 to 24h00). The 183 full days do not have to be consecutive or continuous but, in order to meet the exemption requirements, a total of 183 full days in aggregate during a year of assessment must be exceeded. It is not necessary to exceed this period by a full day. Any amount of time in excess of 183 full days, such as a few hours, will be sufficient.

When calculating whether a person has been outside the Republic for 183 full days, calendar days must be looked at, not work days.

Weekends, public holidays, annual leave days, sick leave days and rest periods that are spent outside South Africa are taken into account for purposes of calculating the period or periods outside South Africa.

If called upon, taxpayers will be required to submit some form of documentation to substantiate their absence from South Africa.²⁰ This documentation may include, without limiting the scope of what could be requested by SARS, a letter of engagement or secondment, employment contracts for foreign services, copies of passports, access to the ship register or a letter from the ship's captain verifying the location of the ship. This documentary proof will assist in the verification of the period or periods worked outside South Africa.

²⁰ Section 46(4) of the Tax Administration Act No. 28 of 2011.

4.6 Apportionment

Section 10(1)(o)(i) does not envisage apportionment. The test under this section is simply a threshold test: once the requirements for exemption have been met, all remuneration derived during the year of assessment from the person's role as an officer or crew member on a qualifying ship will be exempt – even if a portion of the services are rendered in the Republic.

5. General provisions

The potential for an exemption under section 10(1)(o)(i) does not automatically waive the obligation of an employer to deduct or withhold employees' tax under the Fourth Schedule. An employer that is satisfied that the provisions of section 10(1)(o)(i) will apply in a particular case may, however, elect not to deduct or withhold employees' tax in a particular case. In the case where the exemption was not applicable, the employer will be held liable for the employees' tax not deducted as well as the concomitant penalties and interest.

Each remuneration item qualifying for the section 10(1)(o)(i) exemption must be disclosed under the relevant foreign service income source code on the employees' tax certificate (IRP5 certificate). Foreign salary income must, for example, be disclosed under code 3651, bonus payments under code 3655 and medical aid contributions under code 3860.²¹ *Code 3652 may not be used for any remuneration item that may qualify for exemption under section 10(1)(o)(i).*

An employer that has deducted or withheld employees' tax where it subsequently transpires that the remuneration qualifies for exemption under section 10(1)(o)(i) **may not refund over-deducted employees' tax to an employee.**²² The employee must claim a refund on assessment. Supporting documentation in the form of, for example, a passport, an employment contract and confirmation of the ship's location, may be requested from the employee to substantiate the exemption claimed on assessment.

Remuneration that is exempt under section 10(1)(o)(i) is not "remuneration" as defined in paragraph 1 of the Fourth Schedule.²³ As such amounts are not "remuneration", they are not subject to unemployment insurance fund contributions under the Unemployment Insurance Contributions Act No. 4 of 2002 or the skills development levy under the Skills Development Levies Act No. 9 of 1999. Any remuneration that remains taxable in South Africa will still be subject to the payment or withholding of levies or contributions under these statutes.

The exemption under section 10(1)(o)(i) does not apply to other income that a South African resident earns during the year of assessment, for example, investment or trade income.

²¹ For details on the correct IRP5 disclosure, see *Guide for Codes applicable to Employees' Tax Certificates 2015* on the SARS website.

²² Paragraph 29 of the Fourth Schedule.

²³ The term "remuneration" is defined to mean "...any amount of income...". (Emphasis added.) "Income" as defined in section 1(1) excludes exempt income.

6. Conclusion

The remuneration of officers or crew members of ships engaged for reward in the international transportation of passengers or goods, or ships engaged in the prospecting, exploration, mining or production of minerals if employed solely for the passage of such ships, is exempt from taxation if those officers or crew members are outside South Africa for a period or periods exceeding 183 full days in total during a year of assessment.

In certain circumstances, the remuneration of officers or crew members may not be sufficient to qualify for the exemption in section 10(1)(o)(i). It may, however, be possible that the remuneration of these officers or crew members qualify for the exemption under section 10(1)(o)(ii).

Legal and Policy Division

SOUTH AFRICAN REVENUE SERVICE

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Annexure – The law**Section 10(1)(o)(i)**

10. Exemptions.—(1) There shall be exempt from normal tax—

(o) any form of remuneration—

(i) as defined in paragraph 1 of the Fourth Schedule, derived by any person as an officer or crew member of a ship engaged—

(aa) in the international transportation for reward of passengers or goods; or

(bb) in the prospecting, exploration or mining (including surveys and other work of a similar nature) for, or production of, any minerals (including natural oils) from the seabed outside the Republic, where such officer or crew member is employed on board such ship solely for purposes of the “passage” of such ship, as defined in the Marine Traffic Act, 1981 (Act No. 2 of 1981),

if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment;

Definition of “remuneration” in paragraph 1 of the Fourth Schedule

“**remuneration**” means any amount of income which is paid or is payable to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered, including—

(a) any amount referred to in paragraph (a),(c),(cA),(d),(e),(eA) or (f) of the definition of “gross income” in section 1 of this Act;

(b) any amount required to be included in such person’s gross income under paragraph (i) of that definition, excluding an amount described in paragraph 7 of the Seventh Schedule;

(bA) any allowance or advance, which must be included in the taxable income of that person in terms of section 8(1)(a)(i), other than—

(i) an allowance in respect of which paragraph (c) or (cA) applies; or

(ii) an allowance or advance paid or granted to that person in respect of accommodation, meals or other incidental costs while that person is by reason of the duties of his or her office obliged to spend at least one night away from his or her usual place of residence in the Republic: Provided that where—

(aa) such an allowance or advance was paid or granted to a person during any month in respect of a night away from his or her usual place of residence; and

(bb) that person has not by the last day of the following month either spent the night away from his or her usual place of residence or refunded that allowance or advance to his or her employer,

that allowance or advance is deemed not to have been paid or granted to that person during that first-mentioned month in respect of accommodation, meals or other incidental costs, but is deemed to be an amount which has become payable to that person in that following month in respect of services rendered by that person;

- (c) 50 per cent of the amount of any allowance referred to in section 8 (1) (d) granted to the holder of a public office contemplated in section 8 (1) (e);
- (cA) 80 per cent of the amount of any allowance or advance in respect of transport expenses referred to in section 8 (1) (b), other than any such allowance or advance contemplated in section 8 (1) (b) (iii) which is based on the actual distance travelled by the recipient, and which is calculated at a rate per kilometre which does not exceed the appropriate rate per kilometre fixed by the Minister of Finance under section 8 (1) (b) (iii): Provided that where the employer is satisfied that at least 80 per cent of the use of the motor vehicle for a year of assessment will be for business purposes, then only 20 per cent of the amount of such allowance or advance must be included;
- (cB) 80 per cent of the amount of the taxable benefit as determined in terms of paragraph 7 of the Seventh Schedule: Provided that where the employer is satisfied that at least 80 per cent of the use of the motor vehicle for a year of assessment will be for business purposes, then only 20 per cent of such amount must be included;
- (d) any gain determined in terms of section 8B, which must be included in that person's income under that section;
- (e) any gain determined in terms of section 8C which is required to be included in the income of that person;
- (f) any amount deemed to be income accrued to that person in terms of section 7 (11),

but not including—

- (i) . . .
- (ii) any amount paid or payable in respect of services rendered or to be rendered by any person (other than a person who is not a resident or an employee contemplated in paragraph (b), (c), (d), (e) or (f) of the definition of "employee") in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered: Provided that for the purposes of this paragraph a person shall not be deemed to carry on a trade independently as aforesaid if the services are required to be performed mainly at the premises of the person by whom such amount is paid or payable or of the person to whom such services were or are to be rendered and the person who rendered or will render the services is subject to the control or supervision of any other person as to the manner in which his or her duties are performed or to be performed or as to his hours of work: Provided further that a person will be deemed to be carrying on a trade independently as aforesaid if he throughout the year of assessment employs three or more employees who are on a full time basis engaged in the business of such person of rendering any such service, other than any employee who is a connected person in relation to such person;
- (iii) any pension or additional pension under the Aged Persons Act, 1967 (Act No. 81 of 1967), or the Blind Persons Act, 1968 (Act No. 26 of 1968), any disability grant or additional or supplementary allowance under the Disability Grants Act, 1968 (Act No. 27 of 1968), or any grant or contribution under the provisions of section 89 of the Children's Act, 1960 (Act No. 33 of 1960);
- (iv) . . .
- (v) . . .
- (vi) any amount paid or payable to any employee wholly in reimbursement of expenditure actually incurred by such employee in the course of his employment;
- (vii) . . .

(viii) any annuity under an order of divorce or decree of judicial separation or under any agreement of separation;