

THE EFFECT OF TAX TREATY  
LAW ON SOUTH AFRICAN  
NORMAL TAX

*By:*

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## Declaration

I, Msawenkosi Neville Dlamini declare that this dissertation is my own work and has not been submitted previously for any degree in any University.

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# Chapter 1

## 1.1 Introduction

The Income tax act of 1962 as amended by various annual Income Tax Acts constitutes the statutory income tax law of South Africa. The principle of judicial precedent is accepted by the legal system. Decisions of the Appellate Division of the Supreme Court constitute binding authority according to the system of precedent within the hierarchy of South African courts. South Africa imposes its income taxation (normal tax) on source basis. With certain exceptions, notably dividends, only income derived from a source within or deemed to be within South Africa is subject to tax. The nationality, residents or domicile of an individual or the place of incorporation or effective management and control the company are, in the main, irrelevant factors of determining liability for normal tax.

Notwithstanding the fact that the South African Income tax system adopts the territorial principle of taxation, there is no statutory definition of the term "Source", nor are there statutory basic source rules applying to the various types of income. The legislation, however includes some deemed source provisions, deemed to be sourced within the country and subject to normal tax. Court decisions have dealt with the concept of source, but have applied to specific types of income and circumstances. Authoritative principles or mere guidelines maybe extracted from these decisions, which throw some light on the quest for the source of a particular type of income. A brief indication of these principles of factors, which are usually followed in practice by the Revenue authorities, is given below. Specific deeming provisions relating to these types of income are also mentioned.

## 1.2 Motivation for the research

The South African economy has always been an open one, to judge from the volume of its imports and exports. The same appears from the investment picture, where capital imports are increasingly matched by strategic and operational investment outward. Whatever influences the ebb and flow of economic or international political circumstances, this integration of the South Africa's inherent wealth in human and natural resources, and by her own need to develop the prosperity and well-being of her people through international trade and cross border investment. On the other hand, anyone who practices in the international tax area, or who has successfully taken their business across national borders, will testify to the increasing complexity of orchestrating various tax systems so as to keep international business viable. One major tool in this process is the international double tax treaty network.

## 1.3 Value of the project

With some knowledge of what international tax treaties are about, investor and exporter, and their advisors, must surely arrive at a better understanding of the possibilities and limitations contained in a number of our major tax treaties. This case study should be of value to all who are called upon to plan and devise international business interests and transactions entailing economic penetration of South Africa or its tax treaty partners sufficient to permit taxation of whatever activities might be involved.

## 1.4 Problem statement

As financial institutions are closely involved through several specialist departments in supporting businessmen with international interests. The absence of authoritative work on South Africa's comprehensive international tax treaties has always seemed to us to be a disadvantage in solving the business planning problems linked to the development and realization of business interests and transactions crossing our borders. It is clear that different tax systems in various tax jurisdictions, based on different foundations, can have the effect of subjecting the same income to tax twice.

### Example:

The South African tax system, taxes non-residents upon the principle of source, but various other systems are based upon the principle of residence.

### Implication:

A citizen of the United States is subject to tax in that jurisdiction on world-wide income, irrespective of where it is earned. If such a citizen earns income in South Africa and is subject to local tax on that income on the basis of the source principle, the potential for double taxation exists.

The same applies in reverse.

The possibility of double taxation is dealt with in two ways:

1. unilateral relief, granted by one jurisdiction without any link with another jurisdiction.

### Example:

In the case of the United States, provisions exist for the granting of credits in respect of foreign tax paid on income which is subject to United States tax.

Similarly, *s 6quat (SEE ANNEXURE A B)* of the local Act1 provides for a rebate in respect of foreign taxes paid on foreign sourced income which is deemed to be from a South African source.

Unilateral relief can also take the form of a total exemption from tax granted by one exemption, or a qualified exemption

2. bilateral relief, on a basis agreed upon between two governments, in the form of double taxation agreements

The State President is empowered to enter into agreements with the government of any other country or territory, whereby arrangements are made with that government for—

- (a) the prevention, mitigation or discontinuance of the levy of tax by both governments in respect of the same income, profit or gains, or donation;  
or
- (b) the rendering of reciprocal assistance in the administration and collection of taxes under the law of two countries.

The duty of preserving secrecy in respect of tax matters does not prevent the disclosure to an authorised officer of the territory with whom an agreement has been entered into, of facts and knowledge which it is necessary to disclose—

- (a) in order to determine whether immunity, relief or exemption ought to be given under the agreement; or
- (b) in order to render or receive assistance under the agreement.

The State President has, in the exercise of these powers, entered into a number of agreements which fall into two classes:

- (a) comprehensive agreements, covering a number of different types of income; and
- (b) restricted agreements, dealing only with income from shipping and aircraft business.

### 1.5 Comprehensive agreements

A number of comprehensive agreements have been entered into over many years. In recent years the world-wide trend has been towards the use of the model convention developed by the organisation for Economic Co-operation and Development, and this model, in various forms, has been utilized for most of the agreements entered into, particularly those which are more recent. The United States does not normally follow this model. The treaty with the United States was signed in February 1997 and became effective from 28 December 1997.

Since the contents of most of the agreements are similar, the agreement with the United Kingdom has been chosen as a model for the purposes of analyzing the operation of these agreements. This agreement conforms to the model convention of the Organization for Economic Co-operation and Development. This analysis is intended to illustrate the general operation of a standard double tax agreement, and reference must always be made to the applicable agreement.

## 1.6 Objectives of double taxation agreements

The objectives of the agreement are threefold, namely: -

1. The avoidance of Double Taxation,
2. The prevention of fiscal evasion (both of these first two objectives are set out in the preamble to the agreement; and
3. The exchange of information\* (This is perhaps not as important, but is subsidiary to the two major objectives)

\*Article 25 of the agreement reads as follows:

*The taxation authorities of the Contracting States shall exchange such information (being information which is at their disposal under their respective taxation laws in the normal course of administration) as is necessary for carrying out the provisions of the Convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of this Convention. Any information so exchanged shall be treated as secret but may be disclosed to persons (including a court or administrative body) concerned with assessment, collection, enforcement or prosecution in respect of taxes which are the subject of this Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any other trade process.*

It is further provided that no information will be exchanged with regard to trade secrets.

## 1.7 Taxes subject to the agreement

The taxes which are the subject of the agreement are separately set out in respect of the two contracting states.

[NOTE: '**contracting states**' = the two parties to the agreement.]

In the case of South Africa, these taxes are the following:

- (a) normal tax;
- (b) non-resident shareholders' tax
- (c) non-residents' tax on interest
- (d) undistributed profits tax
- (e) provincial income and personal taxes
- (f) secondary tax on companies.

In the case of the United Kingdom, the taxes subject to the agreement are the following:

- (a) income tax (including surtax)
- (b) corporation tax
- (c) capital gains tax

The agreement applies to any identical or substantially similar taxes imposed after the agreement was entered into, in addition to or in replacement of the taxes specified. The term

[NOTE: '**tax**' = taxes specified]

## 1.8 Residence in terms of the agreement

The mechanism of the agreement is based upon laying down certain rules which one jurisdiction must follow in taxing the residents of the other jurisdictions. Therefore it is essential, as a first step in applying the agreement, to determine the residence of a taxpayer for the purposes of the agreement. The rules prescribed ensure that for this purpose a taxpayer can be regarded as a resident of only one of the jurisdictions.

The most common formulation is that for the purposes of the agreement the term

'resident of a Contracting State' =

any person who, under the law of that state, is liable to taxation therein by reason of his domicile, residence, place of management, or any other criterion of a similar nature.

This rule is broad and can result in a taxpayer being categorized as a resident of both states. In such cases further rules are laid down in order to determine residency.

In the case of an individual who falls to be regarded as a resident of both states on the general principle, his status is determined in accordance with the following rules:

1. He is deemed to be a resident of the contracting state in which he has a *permanent home* available to him;

*IF he has a permanent home available to him in BOTH states*



2.He is deemed to be a resident of the state with which *his personal and economic relations are closest*

(referred to for the purposes of the agreement as 'his centre of vital interests')

The determination of this centre of vital interests is a question of fact which may not always be possible.

*IF the state in which he has his centre of vital interests CANNOT BE DETERMINED, or if he has not a permanent home available to him in either state*

3.He is deemed to be a resident of the state in which he has an *habitual abode*

*IF he has an habitual abode in BOTH states or in NEITHER of them*

4.He is deemed to be a resident of the state of which he is a *national*

*IF he is a national of BOTH states or of NEITHER of them*

5.The taxation authorities of the two states determine the question by *mutual agreement*

In the case of a company or any other taxpayer other than an individual who is by reason of the general rule regarded as a resident of both states, the following rules apply:

1. The taxpayer is deemed to be a resident of the state in which its *place of effective management is situated*.

\* In many cases the place of effective management of a company will be the place where the board of directors meets and takes decisions.

\*There is no correlation between

-the place of incorporation

-where the assets or the bulk of the assets are deployed

- where the day-to-day business is carried on

and the place of effective management.

\*In the case of a trust, all the facts of the case must be looked to.

Once the residence of a taxpayer has been established, the remainder of the provisions of the agreement can be applied.

## 1.9 Industrial or commercial profits

The industrial or commercial profits of an enterprise of one state cannot be subjected to tax in the other state unless that enterprise carries on a trade or business in the other state through a permanent establishment established in that other state. In this case the state in which the permanent establishment is situated may tax only those profits which are attributable to the permanent establishment.

For this purpose those profits are to be calculated as if the permanent establishment were an independent enterprise carrying on its trade or business at arm's length with the enterprise of which it is a permanent establishment.

This provision is aimed at preventing the manipulation of profits between the two jurisdictions.

[NOTE: **Permanent establishment** includes the following:

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop;
- (f) a mine, quarry or other place of extraction of natural resources;
- (g) a building site or construction or assembly project which exists for more than 12 months.]

## 1.10 Conclusion

As with any tool, however, tax treaties are only as useful as the user's expertise and familiarity with them allow. This case study will serve as a comprehensive guide to the use of tax treaty tool. There is a keen theoretical insight and many years of practical experience, first with a major bank and then with an international professional firm. The result is in aid to consultants and business persons alike.

## Chapter 2 South African Tax System

### 2.1 Introduction

It has been authoritatively laid down by the South African Courts that by "source" is meant the originating cause of income. Once this question has been decided, it follows that the originating cause has to be located geographically. If more than one cause can be ascribed to the accrual or the receipt of income and such causes are located in different places, the South African Courts look for the dominant, main or substantial cause. Incidental causes are thus disregarded, and the total income is attributed to the main cause. When none of the causes can be considered as being incidental, logic determines that an allocation of the income between the different causes located in different places should follow. Although some of the decisions have discussed and accepted in theory the possibility that only part of a receipt may be sourced within South Africa, none of these decisions really constitutes a legal precedence for the apportionment of income between its different courses located in different countries.

### 2.2 Source

The revenue authorities, however, appear to follow a more practical approach, and accept in practice that a receipt may be apportioned between its causes, and therefore tax only the portion derived from the local source. It seems that this practical approach is followed as long as the foreign courses of the receipt are clearly identifiable and are not merely incidental, and have had a degree of influence in the accrual or receipt. Furthermore, the portion of the receipt allocated to the foreign course must be reasonable in the light of the degree of influence of

that cause. These principles are of a particular importance, for example, to foreign enterprises entering into contracts with South African customers involving various activities such as the design and supply of equipment and installation work. Some of these activities may be performed outside South Africa, while others (for example installation) may take place within the country. According to the Courts general attitude, the income arising from these contracts should be ascribed to its main or dominant cause. This approach may cause profits arising from activities perform totally outside the country (for example design) to be subject to tax in South Africa because these activities will be disregarded as being incidental within the context of the contract as a whole.

It is further submitted that when the activities giving rise to income with a local source are sub-contracted to a local entity the problem, although improved, is not resolved. Where the local activities are the main cause of the contract income, the fact that those activities are carried on by a sub-contractor would normally alter the initial accrual to the foreign contractor and thus the overall source of the contract income. As more definite splitting of source would be achieved if the foreign enterprise were to enter into separate contracts in respect of its different activities, and thus to have different receipt and more visibly separate source for each receipt. The splitting will be further defined if different entities within the foreign group are made parties to various contracts.

In practice the Revenue authorities also seem to accept in some instances an apportionment of total income of a contract according to different locations of its originating causes or activities. Provided that the contractor can substantiate the relationship between the portion attributable to each activity or originating cause and the activity or originating cause itself. Furthermore, the causes located in different countries will be relevant in this regard only if they actually and distinctly contributed to the accrual of the income, as opposed to having been merely

incidental to it, within the context of the contract as a whole. In some instances the fact that the South African courts tend not to accept a splitting of income among its various sources may work to the benefit of the foreign enterprise. This outcome will arise, for example, with contracts entered into by foreign enterprises for the sale of equipment or machinery manufactured outside South Africa involving some local assembly or installation. As long as these services are purely incidental, ancillary or supplementary to the sale, the Revenue authorities accept that they will not give rise to a separate and independent source of income. The services will then normally assume the source of the proceeds of the sales. The question whether the services are purely incidental, ancillary or supplementary to the sales contract depends to a large extent on their technical importance in relation to the contract as the whole, on the relative values of the services and the machinery or equipment sold, and the dependence of the item sold on the services rendered. Other factors such as the number of people involved and the duration of their services in South Africa and the period of the total contract are also relevant.

### 2.2.1 Business Income

The term "Business Income" as used here refers to income derived from the business transactions or business activities in general, such as manufacturing and trading in commodities. The term is used as opposed to passive or investment income such as dividends, and professional income or income from employment. The courts in general seem to ascribe great importance to the determination of the business activities that form the essence of the particular type of business in question. Accordingly the first and most important task will have to be the identification of the type of business operations generally carried on by the taxpayer. The next step will be to define the particular transaction or

event given rise to the income in question and to determine how it forms part of the overall business.

The purpose of this analysis will be to determine the activities that may be regarded as the main or dominant for the accrual of the income. Apart from the main or dominant business activities thus determined, the productive employment of the capital of the business constitutes another major factor considered by the courts. In most instances the employment of capital becomes a factor subordinate to the business activities. Although a factor considered by the courts, the management and control of a business has been given less relevance as a cause for the accrual of business income. Reference is made below to the causes that in practice are generally considered as giving rise to the income derived from certain types of businesses.

### 2.2.2 Mining, farming and manufacturing operations

The productive operations at a mine, farm or factory are usually the main cause of income being earned. Accordingly where the management and control of the business is exercised in a different country from that in which the mining, producing or manufacturing are carried on, the latter will prevail as a critical location. The selling activities are in general relegated to the secondary plan, and are disregarded as being incidental to the mining, producing or manufacturing activities. Under certain circumstances, however, the selling activities may assume greater importance and become a separate cause for accrual of portion of the total profits being earned by the enterprise, for example, when a South African enterprise operates a branch in foreign country that undertakes the selling of its products. The main cause giving rise to the profits derived from the foreign country is the selling activities undertaken by the branch. Consequently,

part of total profits of the enterprise is in practice allocated to the branch activities and considered to be of foreign source and therefore not subject to tax in South Africa.

The principle also applies to a foreign enterprise carrying on business in South Africa. The revenue authorities will tax its receipts from South Africa when the activities of the foreign enterprise in South Africa are of such a nature and degree that they may be said to constitute the main or an important cause of the accrual of at least some of the South African receipt. The local establishment is then treated as a centre separate from the head office. In both instances the problem lies in the determination of how much needs to be done or what degree of activities needs to be undertaken in another country to go beyond incidental activities in order to give rise to a separate cause for the earning of that portion of the total profits of the enterprise. It is submitted that the selling activities are usually elevated to an independent source where they are conducted on a continued basis through fixed presence distinct from the head office.

### 2.2.3 Trading in commodities

The prime element of this type of business is the purchase and sale of commodities. Although it may be said that the Revenue authorities show a general tendency for considering the selling activity as being the cause of accrual of this type of income, it would be wrong to conclude that it is always the country in which the goods are sold that is the country of origin of income. Selling activities includes the services performed by the seller and the conclusion of the contract of sale. In the majority of instances the place where the contracts are concluded identifies the location of the trade carried on. Notwithstanding this general principle, an analysis of the total of taxpayer's activities in the carrying on



of his trade must be made before a conclusion may be drawn regarding the source of his trading income.

It may happen that the purchasing activities constitute the trader's most relevant activities, for example, because they require a special skill or because the purchasing market is extremely difficult and restricted in comparison with the with an unlimited potential for sales. The nature of the functions of the personnel employed in various countries, the degree of their skill, the place where contracts are usually made, the place where the control of the business is exercised and the place where the capital is employed constitute the factors that have to be analyzed in detail. In practice the Revenue authorities do not subject to tax a foreign enterprise with a South African office solely carrying on purchasing or other auxiliary activities, provided that all contracts of sale are concluded outside South Africa. The authorities also do not tax income derived by South African traders with foreign selling activities carried on through a foreign fixed presence or organization whose activities justify the accrual of the income from that particular country. It is of particular relevance that employees working in the foreign country in fact conclude contracts of sale there on behalf of the local trading enterprise. In general if the trader carries on outside South Africa mere purchasing activities through the foreign presence or establishment, these activities are usually ignored by the authorities, as being an incidental factor in the accrual of the trading profits.

#### 2.2.4 Trading in stock and securities

When the taxpayer deals in shares and other securities it is his business of buying and selling that constitute the main cause of his gain and losses. The use of independent brokers who merely execute the taxpayer's instructions is, in

most instances, however, where brokers are not used merely for executing the transactions, and their acts constitute the taxpayer's activities of buying and selling shares or other securities. Importance is attached to the place where the shares or other securities are acquired, where the capital is employed and where the business as a whole is carried on.

### 2.2.5 Allocation rules

The South African legislation provides for an allocation of profits or losses in instances where a local business extends to foreign countries. This is a statutory apportionment of net profits or losses between the local and foreign sources. The allocation may be based on the accounts of the enterprise, where these are proven to be satisfactory, or on the following formula:

$$\text{S.A income/loss} = \frac{\text{Total net taxable profit} \times \text{Value of South African Assets}}{\text{Loss from all sources} \quad \text{Value of Total assets}}$$

Not statutory reference is made to the values to be assigned to the assets. It seems that in practice book values are accepted (cost less depreciation and provisions on trading stock) by the Revenue authorities. This provision does not apply where the taxpayer carries on outside South Africa a business distinct or separate from his South African business.

In general, it may be difficult to determine when the foreign operations are no longer an extension of a local business but form part of a separate or distinct foreign business. In practice, however, the Revenue authorities tend to accept that a permanent foreign presence carrying on distinct operations gives rise to separate business with an independent source of income, and the formula is seldom used.

Certain types of businesses that by nature are bound to extend to more than one country, such as shipping and air transport, are excluded by law from the application of this provision.

### 2.2.6 Contract of Sale

In the above discussion on the source principles applicable to business income, reference is made to the importance of the place of conclusion of contract of sale. Apart from being a factor influencing the prime source of trading proceeds, the greatest importance attached to the place of the conclusion of the contract stems from the South African legislative deeming provision,

### 2.2.7 Dividends

The agreement restricts the taxation of dividends in the state in which the company paying the dividends is a resident.

Dividends are defined for this purpose as meaning—

- (a) income from shares participating in profits;
- (b) income from other rights (excluding debt claims) participating in profits;
- (c) income from other corporate rights assimilated to income from shares by the tax laws of the state in which the company making the distribution is resident;
- (d) any other item of income (other than royalties exempt from tax in terms of the agreement) which is treated as a dividend or distribution of a company under the law of the state in which the company concerned is a resident.

The rules applying to dividends are as follows:

- (a) dividends which are paid by a company which is a resident of one state to a resident of the other state may be taxed in that other state
- (b) dividends which are paid by a company which is a resident of one state to a resident of the other state may also be taxed in the state in which the company is a resident, subject to a maximum rate of 15 per cent of the gross amount of dividends, provided that these dividends are either—
  - (i) beneficially owned by a company which is a resident of the other state; or
  - (ii) paid to a resident of the other state who is subject to tax on the dividends in that state
- (c) in the situation contemplated in (b), the rate of tax charged cannot exceed 5 per cent of the gross amount of the dividends if the dividends are beneficially owned by a company which is a resident of the other state, and which controls, directly or indirectly, at least 25 per cent of the voting power of the company paying the dividend. The meaning of the phrase 'voting power' is not defined, and the question whether this test is met will have to be answered in the circumstances of each case;
- (d) the rules set out in (a), (b) and (c) do not apply if the recipient of the dividends, a resident of one of the states, has in the other state, in which the company paying the dividends is resident, a permanent establishment with the business of which the shareholding concerned is effectively connected. In this case the dividends are regarded as part of the industrial and commercial profits of that permanent establishment;
- (e) the maximum rates of 5 per cent and 15 per cent specified in (b) and (c) do not apply where a shareholding of 10 per cent or more was acquired primarily for the purpose of securing this reduction in rate and not for bona

vide commercial reasons, and the dividends concerned were paid out of profits earned 12 months or more before the date on which the 10 per cent shareholding was reached. This provision applies only if the shareholder concerned does not suffer tax on the dividends in the state of which it is a resident; and

- (f) where a company which is a resident of one state derives profits or income from the other state, that other state may not impose any tax on the dividends paid by the company to persons who are not residents of that other state, or subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other state. By way of example, if a company which is a resident of the United Kingdom derives income in the Republic, dividends paid by that company to residents of the United Kingdom cannot be subjected to tax in South Africa, even though paid from the income generated locally. In the absence of this provision, the company concerned would be subject to non-resident shareholders' tax on that portion of the dividends paid which was funded from local income.

The maximum rate of tax levied on dividends of the nature described is non-resident shareholders' tax at the rate of 15 per cent. The reduction in the rate to 5 per cent does not apply to all double taxation agreements.

## 2.2.8 Interest

The rate at which tax may be levied on interest is limited in terms of the agreement. Interest is defined for this purpose as meaning income from the following:

- (a) Government securities;
- (b) bonds or debentures, whether or not secured by mortgage, and whether or not carrying a right to participate in profits;
- (c) other debt claims of every kind; and
- (d) other income assimilated to income from money lent by the tax law of the state in which the income arises.

The provisions applying to interest are as follows:

- (a) interest arising in one state and paid to a resident of the other state may be taxed in that other state;
- (b) interest arising in one state and paid to a resident of the other state may be taxed in the state in which it arises, at a maximum rate of 10 per cent of the gross amount of the interest, if the recipient is subject to tax on that interest in the other state;
- (c) the 10 per cent limitation set out in (b) does not apply if the recipient of the interest has in the state in which the interest arises a permanent establishment and the debt claim giving rise to the interest is effectively connected with a trade or business carried on through that permanent establishment. In this case the interest is treated as part of the industrial or commercial profits of that permanent establishment;

- (d) any provision in the law of one of the states which relates only to interest paid to a non-resident company with or without any further requirement, or which relates only to interest payments between interconnected companies, may not operate so as to require that interest be left out of account in determining the taxable profits of the company paying the interest, on the basis that the interest is regarded as a dividend or distribution. This limitation does not apply, however, to interest paid to a company which is a resident of one state and in which more than 50 per cent of the voting power is controlled directly or indirectly by a person or persons resident in the other state;
- (e) interest is deemed to arise in one state where the payer is that state, a political subdivision, a local authority or a resident of that state. This is not necessarily the same as the source of that interest in terms of the South African source rules. If, however, the person paying the interest, whether or not a resident of one of the two states or not, has in one of the states a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and the interest is borne by that permanent establishment, the interest is deemed to arise in the state in which the permanent establishment is situated; and
- (f) where, as a result of a special relationship between the payer and recipient of the interest, or between both of them and some other person, the amount of interest paid, having regard to the debt claim for which it is paid, exceeds the amount which would have been agreed upon between payer and recipient in the absence of that relationship, only the amount which would have been paid is treated as interest for the purpose of the provisions described above. The existence or otherwise of a special

relationship, and the exact boundaries of the meaning of that phrase, which is not defined, is a question of fact.

### 2.2.9 Royalties

The rate of tax which may be levied on royalties is limited in certain circumstances. Royalties are defined for this purpose as meaning payments of

any kind received as a consideration for the use of, or the right to use, the following:

- (a) any copyright of literary, artistic or scientific work, including cinematograph films and films or tapes for radio or television broadcasting;
- (b) any patent, trade mark, or design;
- (c) any model, plant, secret formula or process;
- (d) industrial, commercial or scientific equipment; or
- (e) information concerning industrial, commercial or scientific experience.

For this purpose royalties do not include any amount paid in respect of the operation of a mine, oil well or quarry, or of any other extraction of natural resources.

The rule applying to royalties is simple:

Royalties arising in one state and paid to a resident of the other state who is subject to tax there on those royalties is exempt from tax in the first state.

This is NOT a universal principle in the agreements entered into by South Africa. This exemption overrides the normal South African rules, which effectively subject royalties to a withholding tax of 12 per cent.



The exemption from tax in respect of royalties does not apply in two sets of circumstances:

(a) if the recipient of the royalties, a resident of one of the states, has in the other state a permanent establishment, and the right or property giving rise to the royalties is effectively connected with a trade or business carried on through that permanent establishment. In this case the royalties are treated as part of the industrial or commercial profits of that permanent establishment;

(b) where royalties arising in one state are paid to a company which is a resident of the other state, and—

1. the same persons participate directly or indirectly in the management or control of the company paying the royalties and the company deriving the royalties; and
2. more than 50 per cent of the voting power in the company deriving the royalties is controlled directly or indirectly by a person or persons resident in the state in which the company paying the royalties is resident.

Where, as a result of a special relationship between the payer and recipient of royalties, or between both of them and some other person, the amount of the royalties paid, having regard to the use, right or information for which paid, exceeds the amount which would have been agreed upon between those parties in the absence of the special relationship, the provisions set out above apply only to this amount.

### 2.2.9.1 Summary of maximum tax rates on dividends, interest and royalties

The rates of withholding taxes which may be imposed on dividends, interest and royalties differ for the various agreements. The table below shows the actual rates applicable in terms of some of the double taxation agreements.

Rates of withholding taxes (%) in terms of double taxation agreements:

	Dividends (a)	Interest (b)	Royalties (c)
	%	%	%
Algeria	0	0	10 (h)
Australia	0	0	10
Austria	0	0	0
Belgium	0	0	0 (h)
Botswana	0	0	12
Canada	0	0	6 (i)
China (People's Republic)	0	0	10 (h)
China (Taiwan)	0	0	10 (h)
Croatia	0	0	5
Cyprus (g)	0	0	12
Czech Republic	0	0	10 (h)
Denmark	0	0	0 (h)
Egypt	0	0	12
Finland	0	0	0 (h)
France	0	0	0 (d)
Gambia (g)	0	0	12

Germany	0	0	0 (d)
Grenada (g)	0	0	12
Hungary	0	0	0 (h)
India	0	0	10 (h)
Indonesia	0	0	10 (h)
Iran	0	0	10 (h)
Ireland	0	0	0 (h)
Israel	0	0	0 (f)
Italy	0	0	6 (h)
Japan	0	0	10
Korea	0	0	10 (h)
Lesotho	0	0	10
Luxembourg	0	0	0 (h)
Malawi	0	0	0 (d)
Malta	0	0	10
Mauritius	0	0	0
Namibia	0	0	0 (d)
Netherlands	0	0	0
Nicaragua (g)	0	0	12
Norway	0	0	0 (h)
Pakistan	0	0	10 (h)
Poland	0	0	10
Romania	0	0	12
		Dividends (a) Interest (b)	Royalties (c)
Russian Federation	0	0	0
Seychelles (g)	0	0	12

Sierra Leone (g)	0	0	12
Singapore	0	0	5(h)
Slovakia	0	0	10
Swaziland	0	0	0 (d)
Sweden	0	0	6 (e,h)
Switzerland	0	0	0
Tanzania	0	0	12
Thailand	0	0	12
Tunisia	0	0	10
Uganda	0	0	6
United Kingdom	0	0	0 (d)
United States of America	0	0	0
Zambia	0	0	0 (d)
Zimbabwe	0	0	0 (d)
Non-treaty countries	0	0	12

Notes:

- (a) Dividends are not subject to withholding tax in South Africa.
- (b) Interest is not subject to withholding tax in South Africa.
- (c) The actual rate of tax due under South African domestic law is 10,5%, but the recipient must file a tax return to obtain a refund of the 1,5% excess.
- (d) Exempt if subject to tax in recipient country; otherwise 12%.
- (e) Royalties from copyrights are exempt; otherwise the rate is 6%.
- (f) In general, exempt if subject to tax in Israel, otherwise the rate is 12%.
- (g) An agreement signed in 1946 between South Africa and the United Kingdom was extended to apply to these countries and is apparently still in force.

- (h) Rate applies only if the recipient is the beneficial owner of the royalties.
- (i) The rate is 10% for franchise royalties.
- (j) For rental of equipment the rate is 7%.

**General note:**

Most treaties provide that when the property giving rise to the dividend, interest or royalty is effectively connected to a permanent establishment in the Republic, such dividend, interest or royalty is treated as part of the industrial or commercial profits of the permanent establishment and the withholding taxes are not imposed. Instead, the amount will be taxed in the hands of the permanent establishment in the normal way.

## 2.2.10 Income derived from ships and aircraft

A resident of one of the states is "exempt" from tax in the other state on profits from the operations of ships or aircraft, except in respect of profits from voyages of ships or aircraft confined solely to places in the other state

## 2.2.11 Income from immovable property

Income from immovable property may be taxed in the state in which the property is situated. Income for this purpose means income derived from the direct use, letting or use in any other form of immovable property. This rule applies also to income from immovable property of an enterprise, and to income from immovable property used for the performance of professional services.

The meaning of immovable property for this purpose is determined in accordance with the law of the state in which the property is situated, but in all cases includes the following:

- (a) property accessory to immovable property;
  - (b) livestock and equipment used in agriculture and forestry;
  - (c) rights to which the provisions of general law respecting landed property apply;
  - (d) usufruct of immovable property; and
  - (e) rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.
- Ships, boats and aircraft are **NOT** regarded as immovable property.

## 2.2.12 Income from professional services

Income derived by a resident of one state in respect of professional services or other independent activities of a similar character is subject to tax in that state, unless that taxpayer has a fixed base regularly available to him in the other state for the purpose of performing his activities. In the latter case, the income attributable to that fixed base may be taxed in the state in which it is situated.

## 2.2.13 Income derived from services rendered

A number of provisions in the agreement apply to income derived from services rendered. These may be summarized as follows:

- (a) salaries, wages and other similar remuneration derived by a resident of one state in respect of an employment are subject to tax in that state only,

unless the employment is exercised in the other state, in which case the remuneration derived from the other state may be taxed in that state;

- (b) Notwithstanding the general rule described in (a), remuneration derived by a resident of one state in respect of an employment exercised in the other state may be taxed in the state of residence only if three conditions are met:

  - (i) the recipient is present in the state in which he is not resident for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned;
  - (ii) the remuneration is paid by or on behalf of an employer who is not a resident of the state in which the recipient is not resident; and
  - (iii) the remuneration is not deducted from the profits of a permanent establishment or a fixed base which the employer has in the state in which the recipient is not resident;
  
- (c) the provisions in (a) and (b) apply to remuneration of a director derived from a company as if this remuneration were remuneration of an employee in respect of an employment, and as if all references to the employer were references to the company concerned;
  
- (d) notwithstanding the provisions of (a), (b) and (c), remuneration for personal services performed aboard a ship or aircraft in international traffic may be taxed in the state of which the person deriving the profits from the operation of the ship or aircraft is a resident;
  
- (e) notwithstanding any other provisions of the agreement, income derived by public entertainers such as theatre, motion picture, radio or television

artists and musicians, and by athletes, from their personal activities as such, may be taxed in the state in which these activities are exercised;

- (f) a professor or teacher who visits one of the states for a period not exceeding two years for the purpose of teaching at a university, college, school or other educational institution of that state, and who is, or was immediately before his visit, a resident of the other state, is exempt from tax on any remuneration derived from his teaching in the state being visited, if taxable on that remuneration in the other state;
- (g) payments which a student or business apprentice from one state, who is present in the other state solely for the purposes of his education or training, receives for the purpose of his maintenance, education or training, are not taxed in the state in which he is so present, if these payments are made to him from sources outside that state;
- (h) remuneration (other than pensions) paid by one state to any individual for services rendered to that state in the discharge of government functions (including those connected with the Administrations of the provinces) is exempt from tax in the other state if the individual is not ordinarily resident in that other state, or is ordinarily resident in that other state solely for the purpose of rendering those services. This does not apply, however, to payments in respect of services rendered in connection with any trade or business carried on by either of the two states for the purposes of profit;
- (i) any pension paid by one state to any individual for services rendered to that state in the discharge of government functions (including those connected with the Administrations of the provinces) is exempt from tax in



the other state, in so far as the remuneration for the services concerned was exempt from tax in that other state in terms of (h);

- (j) pensions and annuities (other than those referred to in (i)) derived from sources within one of the states by an individual who is a resident of the other state and subject to tax in that state in respect thereof, are exempt from tax in the state from which sourced. The term 'annuity' for this purpose means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

#### 2.2.14 Income not dealt with

Any income not otherwise dealt with in the agreement which is derived by a resident of one state who is subject to tax on that income in the state of residence, may be subjected to tax only in that state.

#### 2.2.15 Further provisions of the agreement

Articles 21 to 28 of the agreement contain further provisions which are primarily of an administrative nature, dealing with the practical implementation of the agreement. The effect of those relevant may be summarized as follows:

- (a) with certain exceptions, individuals who are residents of one state are entitled to the same personal allowances, relief and reductions as citizens of the other state who are not resident in that other state. This does not apply where the

income of the individual concerned, who is a resident of one state and derives income from the other state, consists solely of interest, dividends or royalties;

(b) the method of avoiding double taxation, in the case of the United Kingdom, is by way of allowing a credit for the South African tax paid on income also subject to tax in the United Kingdom. In the case of South Africa, the income concerned may be exempted from tax, or a credit of the United Kingdom tax paid, up to a limit of the amount of South African tax payable on that same income, may be granted;

(c) for the purposes of (b), remuneration for personal (including professional) services performed in one state shall be deemed to be income from sources within that state, and the services of an individual whose services are wholly or mainly performed in ships or aircraft operated in international traffic by a resident of one state shall be deemed to be performed in that state;

(d) where profits on which an enterprise of one state has been charged to tax in that state are included in the profits of an enterprise in the second state on the basis that those profits would have so accrued if all relations between the two enterprises had been at arm's length, the amount of these profits included in the profits of both enterprises is treated for the purposes of (b) as income from a source within the second state of an enterprise of the first state, and relief must be given according to the rules described in (b);

(e) the nationals of one state may not be subjected, in the territory of the other state, to any taxation or connected requirement which is other or more burdensome than the taxation and connected requirements to which nationals in the other state in the same circumstances are or may be subjected.

Similarly, the tax on a permanent establishment which an enterprise of one state has in the second state may not be less favorably levied than the tax levied on enterprises of the second state carrying on the same activities;

(f) either state may give notice, through diplomatic channels, of termination of the agreement, provided that this is done on or before 30 June in any calendar year. In this case the agreement ceases to have effect, so far as the taxes specified below are concerned, on the dates given:

1. United Kingdom income tax (including surtax) and capital gains tax, years of assessment beginning on or after 6 April, in the calendar year following that in which the notice is given;
2. United Kingdom corporation tax, for financial years beginning on or after 1 April, in the calendar year following that in which the notice is given;
3. South African income tax, for years of assessment beginning on or after 1 March, in the calendar year following that in which the notice is given;
4. South African non-resident shareholders' tax, for dividends declared on or after 1 March, in the calendar year following that in which the notice is given;  
and
5. South African non-residents' tax on interest, on interest payable on or after 1 March, in the calendar year following that in which the notice is given.

## 2.3 Conclusion

The South African treaties may thus modify and, in some instances, override the South African Income Tax Act. Since they are part of the statutory law, however, they are equal to this law. Consequently, it is submitted that a domestic tax provision if it specifically intended to do so and is enacted after a treaty has become law. Such an act, however, may constitute a breach of the treaty and a violation of international law. Treaties are terminated when the State President revokes them by proclamations, also notified in the Gazette. In conclusion, all treaties form part of the statutory body of the South African tax law. Under no circumstances can they extend beyond the framework authorized by the national law. The treaties form part of the South African domestic law but at the same time international treaties. The fact that they are incorporated in the South African statutory law makes the South African courts competent to decide a claim founded on a treaty. Therefore when a dispute arises about the application of a treaty provision, the taxpayer is entitled to use the ordinary legal means available under the South African domestic tax legislation.

#### General Principles of Interpretation of Domestic Tax Law

The act of applying tax laws to a particular set of facts involves two separate processes:

- The study and interpretation of the tax law in relation to the type of facts involved in the case.
- The assessment or evaluation of those facts to determine their relevance for purpose of application of the tax law.

## Chapter 3

### 3.1 Introduction

South Africa levies a withholding tax on dividends, the non – resident shareholders' tax (NRST), at a flat rate of 15% on the gross dividend. The prerequisites of the law for the imposition of NRST lead to interesting results. NRST is levied on dividends paid or payable, amongst others, to the following shareholders:

- Individuals (including trusts) not ordinarily resident or carrying on business in South Africa.
- Non-South African Companies (that is , Companies incorporated outside South Africa)
- Holders of bearer scrip.

The determination of the person who is the shareholders is made at the date at which the dividend is declared, unless a different date is fixed as being the date on which registered shareholders are entitled to it is deemed to be the date of declaration. Both the terms `dividend` and `shareholder` are statutorily defined. A member of close corporation is included in the definition of shareholder, and thus subject to NRST on distributions made by close corporation. Liquidation distribution declared out of capital profits are excluded from the statutory definition of `dividends`. Consequently, they will not subject to NRST. The definition of `shareholder` includes not only the registered shareholder but also any person who is entitled to participate in the profits or income attaching to the share. As long as the shareholder's address appearing in the share register of

the company is a foreign address or dividends are paid to the holder of bearer scrip, the company making the distribution is responsible for the payment of NRST on behalf of that shareholder. If, however, the beneficial shareholder is in fact a South Africa company or a resident individual not liable for NRST, a refund of the tax withheld will be made. This refund is not available to holders of bearer scrip that are South African companies or who are resident individuals.

### 3.2 Non-resident Shareholder's Tax

If the shareholder is a company incorporated in South Africa, regardless of its place of effective management and control, no liability for NRST will arise on dividends paid to that company out of South African sourced profits. The location of the effective management and management of the South African company within certain countries may provide a total exemption of NRST based on the provisions of a treaty on the redistribution of these dividends to a foreign shareholder. If the dividends are paid to a local agent of the foreign shareholder, the obligation to pay NRST on behalf of that shareholder vests in the agent, provided the agent's local address appears in the share register of the company. The company will be liable for the deduction of the NRST from dividends distributable to a person who has a foreign address appearing in the share register of the company or to any holder of bearer scrip. Although in principle the date of declaration of the dividends is taken into account in the determination whether NRST is to be withheld, this date is irrelevant when the date for payment of the tax is ascertain. The payment of NRST becomes due within thirty days of

- The date on which the dividends are payable, if the dividends are payable by distributing company directly to the shareholder, or

- The date of delivery of the dividend warrant or cheque in payment of the dividends if they are paid at the address of the South African agent of the foreign shareholder.

The fact that the law places relevance on two different dates (the date of declaration of the dividends and the date of payment of the dividends) leads to the situation that if payment of dividend does not occur, the liability for NRST never becomes effective. It is important to note that NRST is imposed only on dividend that are declared out of profits sourced in South Africa and not necessary to all dividends paid by South African companies. The Consequences of this basis of taxation are:

- When South African companies derives income from sources within and outside the country only a portion of the dividends is subject to NRST in the same ratio that the net profits of the company from South African sources bear to its total net profits. This ratio is determined by the commissioner from financial statements of the company for the latest financial year for which financial statement has been prepared. In terms of the Revenue authorities` practice the net profits of the company for purposes of the application of the ratio are net profits for the year of assessment which are available for dividend distribution, and disbursements for donation or other normally inadmissible items and items debited to the profit and loss and appropriation account must also be deducted to arrive at such profits. Reserves providing for specific contingencies and taxes on income are also not deductible in the calculation of the net profits. This ratio will apply to future dividends until a new ratio is determined. In practice the company paying the dividends requests the Commissioner to determine a new ratio when there is a change in the basis on which the last ratio has been determined. It is the view of the Revenue authorities that the profits on

which the ratio is determined do not include retained earnings but refer only to current profits for the financial year in which the determination is made. This practice has the result that each dividends declared is deemed to have paid out of South African and foreign profits in the ratio as last determined by the Commissioner. Thus if the company declares dividends only out of South African profits (for examples , where the foreign profits were restricted under foreign exchange control) and retains the foreign profits, the ratio may be used to decrease the NRST applicable to those dividends. If, however, the company subsequently declares dividends out of its retained foreign profits, those dividends will be subjects to NRST in terms of the last ratio determined, regardless of the fact that they are paid entirely or largely out of foreign profits.

- Dividends paid by South African companies deriving income only from foreign sources are not subject to NRST. South Africa may thus be used as a tax haven in a similar way as the United Kingdom can be by a United Kingdom non-resident company. Exchange control regulations, as well as the rules and practice on the source of income, will have to be considered before South Africa is used as a tax haven.
- Foreign companies deriving profits from South African sources (for instance, through a local branch operation) are required to withhold NRST on the portion of the dividends declared out of South African profit. Most of the treaties signed by South Africa,
- however, provide an exemption from NRST on dividends paid under these circumstances. When no such exemption is available the revenue. Revenue authorities are faced with practical problem of enforcing the withholding of



NRST by foreign companies , although they may look towards the local branch assets for satisfaction of that liability

As already mentioned, companies are exempt from normal tax on (most) dividends while individuals will be exempt from normal tax on South African Dividends only if they are neither ordinarily resident nor carrying on business within South Africa. Both requirements must be fulfilled for the exemption from normal tax to apply on dividends declared to individuals. South African tax law does not include provisions requiring a minimum debt/equity ratio or imposing a maximum rate of interest on shareholders loans. Therefore the payment of interest to shareholders on their funds is not re-characterized as being disguised, deemed or constructive dividends, with the consequent disallowance of the deductibility of the interest for the company and the corresponding imposition of NRST upon the foreign shareholder. A disallowance of the deduction by the company of the interest paid to shareholder may occur when the general requirements for deductibility are not present, such as in the situation where interest has been incurred for non-trading purposes. When the rate of interest paid on shareholder's loans is grossly excessive, a disallowance at least of part of the interest deduction may occur, on the basis that the interest has not been incurred in the production of the income of the company. The South African exchange –control authorities exercise control over debit /equity ratio of 3:1 is acceptable to them. It should be noted that foreign loans required the prior approval of the authorities. A South African company is required to obtain the prior approval of the Reserve bank for making loans to its foreign shareholders. A statutory re-characterization of loans made by a private company to its shareholders as deemed dividends if the company could have properly distributed those amounts as dividends are not applicable for purposes of NRST.

### 3.3 Non-residents Tax on Interest

Non – residents` tax on interest (NRTI) is charged at a flat rate of 10% on the gross interest paid to, amongst others,

- A non –South African company (that is , a company incorporated outside South Africa) or
- An individual (including trust) not ordinarily resident in South Africa by a debtor who is ordinarily resident or carries on business in South Africa.

The source of the interest is immaterial for purposes of the levying of the NRTI. Companies managed and controlled in South Africa are deemed to be resident in the country for purposes of the determination of liability for NRTI. Contrary to the treatment of dividends , where companies and `non– ordinarily` resident individuals not carrying on business in South Africa are exempt from normal tax and subject only to the dividends withholding tax , interest accruing to foreign companies or non-ordinarily resident individuals is not , as such, exempt from normal tax. If the interest is sourced or deemed to be sourced in South Africa, the normal tax will also be imposed. A rebate (that is, credit against tax) for the NRTI withheld will be allowed against the liability for normal tax when both taxes are payable. When the normal tax payable on the interest is lower than the NRTI withheld no refund of the NRTI is made. For purposes of the rebate, if someone who is not ordinarily resident derives other South African sourced income, the normal tax attributable to the interest will in practice be calculated as being the different between the normal tax on his total income sourced in South Africa and normal tax on his income less the interest. Particular attention must therefore be paid when loans are made to South African companies or residents so as not to

create a local source for the interest. This precaution will be unnecessary where the lender is a resident in certain countries whose treaties provide a limitation on the rate of South African taxes on interest paid to their residents. Interest accruing from the Government, the electricity Supply Commission, the South African Reserve Bank or the South African Broadcasting Corporation is exempt from NRTI. It is also exempt from normal tax provided that it accrues to the foreign company or foreign resident not carrying on business in South Africa. When the interest refers to a loan raised in a foreign country this exemption from normal tax will apply only if the Minister of Finance has given an undertaking to that effect and the stock or securities have been acquired outside South Africa and have been paid for with foreign currency. In this instance, the fact that the foreign company or foreign resident carries on business in South Africa is irrelevant. Interest accruing to non-residents from deposits with South African banks is usually subject to both normal tax and African bank is usually subject to both normal tax and NRTI. In the majority of instances the source of interest accruing on South African banking deposit is located in South Africa. Other exemptions from NRTI that might be of interest include:

- Interest of bills of exchange or promissory notes issued in respect of goods imported into South Africa.
- Interest on any form of financing , for the period not exceeding twelve months , on the import or export of goods provided that financing has been arranged by or through by authorized dealer in foreign currencies in South Africa.
- Interest on foreign loans if the Minister of Finance has been satisfied that  
(a) The loan will be used for long- term industrial or mining development or for housing or community development schemes, and

(b) The South African debtor bears, in terms of the loan agreement, the cost of any South African taxes charged on the interest.

NRTI is payable by the South African debtor or the South African agent of the non-agent of the non-resident receiving the interest within fourteen days after the date of its accrual (that is, after the date on which the non-resident becomes unconditionally entitled to the interest). The term 'interest' is not statutorily defined and must be given its ordinary meaning. Interest in respect of loans or the extended credit facilities given on the purchase of goods sold and delivered or imposed as a penalty on the late payment of a sum due therefore constitutes interest for purposes of NRTI.

### 3.4 RULES FOR RESOLVING CONFLICTS OF DUAL RESIDENCE

Since the definition of a 'resident' in the treaties usually incorporates the domestic tax rules relating to this concept. Conflicts of dual residence are likely to arise, because domestic tax principles on residence seldom coincide. The treaties that follow the OECD model articles on residence (including the German treaty) provide rules aimed at solving conflicts of dual residence. The older tax treaties (treaties with the United States, Sweden and Canada) do not include any provisions aimed at determining single residence.

A conflict of double residence of a corporate entity is unlikely to arise in the treaties with the United States and Sweden, since these treaties regard the place of incorporation as a factor determining corporate residence. Because it is most unusual for a company to incorporate under the laws of both contracting states, conflicts of dual residence are not expected. The absence of rules resolving conflicts of dual residence of individuals or companies (Canada treaty) may lead

to the undesired result that the `dual` resident is unable to invoke the treaty. Only through provision for mutual agreement may some relief be afforded to the `dual` resident.

Since South Africa generally levies income tax on a source basis , however double taxation based on dual residence is not likely to arise in practice. The other treaties , which closely follow the OECD model article on residence (Including the German treaty) , have adopted factual concepts , which appear in the concept of residence in some domestic tax laws in order to solve conflicts of dual residence. The sequence of their application in solving conflicts of dual residence is also laid down.

### 3.4.1 Individuals

The criteria adopted to solve conflicts of dual residence of individuals include:

- The availability of permanent home.
- A centre of vital interest (where permanent home is available in both countries).
- A habitual abode (if the individual does not have a permanent home in either country or his centre of vital interest cannot be determined).
- Nationality (if he has a habitual abode in both countries and neither country).
- The procedure for mutual agreement (if the dual resident is a national of both countries or neither of them).

Although the concepts of a `permanent home`, `center of vital interests and habitual abode` have no formal meaning under the South African Revenue authorities when determining residence. The act of ascertaining their existence involves factual determinations, which are often difficult to make and controversial. The internal laws of European countries, however, are more

familiar with this terminology. It is submitted that because of the absence of South African definitions for tax purposes of these concepts these expressions should be given their general international meaning, with specific reference to the OECD commentary.

### 3.4.2 Permanent home

The first test adopted in the resolution of conflicts of dual residence considers the availability of a permanent home in one contracting state as constituting a closer connection for the determination of residence. This concept may be analyzed in its three elements: the existence of a `home` and its qualifications of being `permanent` and `available` to the individual. The commentary observes that "any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room)". Owned or hired property, including a room in a hotel, will qualify, provided that the further requirements of some degree of permanence and relative continuity or maintenance of this facility are present. According to the ordinary meaning of the English word `home` and also its use in some United States tax treaties, it has been argued that it is not merely a `place` as suggested by the commentary. Some connection with the individual's should exist for the place to be a `home`. The test does not seem to be entirely objective. The intention of the resident to live there with his family may play a role, although only a minor one. The word `permanent` narrows the scope of the test, for it does not include any home but only a permanent home. The OECD commentary states that the requirement that the home must be permanent means that `the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration`. The commentary adds :

But the permanence of the home is essential, this means that the individual has arranged to have the dwelling available to him at all time continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, attending a course at a school etc).

It is clear that the word “permanent” is used in contrast to the words “temporary” and “occasional”. It further tends to be an objective test in which intention plays little or no part. Finally, the home must be `available` to the individual on a continuous basis. Availability for occasional purposes does not suffice. It seems that hired property must be available under a long term lease continually renewed.

### 3.4.3 Centre of vital interest

The second test, which applies if the individual is found to have permanent homes available to him in both contracting states, gives preference to the state in which centre of vital interests is located. It is located in the place where the major part of his economic activities is carried out and his personal connections are closest. The carrying on of a business, as well as the location of his wealth, are elements of his economics ties. The type of activity, if any, carried on, the relative values of investments in both countries and their nature (for example, whether they are passive portfolio investments or active participation in business) are analysed. Family links will play a major role in the determination of his personal attachments. Other personal ties such as the existence of close friends and greater number of acquaintances as well as social and political activities are also considered. It is the total context of the individual's interests, both personal and economic, that must be determined. This view is confirmed by the OECD commentary, which states:

“Thus regard will be held to his family and social relations, his occupations, his political, cultural and other activities, his place of business, the place from which he administers his property, etc. the circumstances must be examined as a whole, but is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention.”

The last comment indicates that when a person's economic interests are found in a country different from his personal interests, such as when he works in one country and lives in another, personal relations should prevail over business ties. The 'centre of vital interest' test is a factual test, which must be determined objectively. Intention cannot form its basis, although it may become relevant in finely balanced circumstances. There is a similarity between this test and the test of a permanent home. Because income tax is an annual tax, some authors suggest that the centre of vital interests test must be applied each year rather than generally over a period. It is submitted, however, that the test should apply over a period.

#### 3.4.4 Habitual abode

In the absence of a permanent home in either of the contracting states, or if it is impossible to determine the centre of vital interest, the third test is applied: the maintenance of a habitual abode in one of the contracting states. The concept of a habitual abode requires the individual to live habitually in a country but not necessarily to live in one particular place within that country. The commentary confirms that chief characteristics of a habitual abode in clarifying the point that this test is used to tip the balance towards the state in which the individual who maintains permanent homes in both countries stays more frequently.

“For this purpose regard must be had to stays made by the individual not only



at the permanent home in the state in question but also at any other place in the same state. The English noun `abode` may include either a place, such as a house, or the more abstract concept of `residing`. Through the qualification of that abode as being `habitual`, it is the meaning of `residing` that is intended. It must be part of the individual's life to reside in a particular state. Therefore the test cannot be annual determination but must cover a sufficient length of time to justify the requirement of being habitual. This interpretation is also confirmed by commentary when it states: "The comparison must cover a sufficient length of time for it to be possible to determine whether the residence in each of the two states is habitual and to determine also the intervals at which the stays take place." An occasional temporary presence in a state is not sufficient to establish a habitual place of abode. The circumstances under which an individual stays in a country must indicate that he is not there merely temporarily. It is submitted that the test is not a mere comparison of time spent in each country. What must be determined is whether it is a more normal part of the individual's life to live in a particular state than in other state. Nevertheless, when referring to an individual who has a permanent home available to him in neither contracting state the commentary says: "In this case all stays made in a state must be considered without it being necessary to ascertain the reason for them."

### 3.4.5 Nationality

Preference will be given to the state in which the individual is a national in the event that he has a habitual place of abode in both or in neither of the contracting states. In determination of his nationality, only the internal laws of that state concerning citizenship are applied.

### 3.4.6 Mutual Agreement

Finally, when nationality does not resolve the conflict of dual residence the competent authorities will settle the question by mutual agreement. The competent authorities have the 'duty of resolving the difficulty by mutual agreement', as the commentary states. Therefore both states are bound to resort to the procedure for mutual agreement is not reached; there seems no way to solve the impasse.

### 3.4.7 Companies

Because it would not be an adequate solution to attach importance to a purely formal criterion like registration, the OECD model adopts the place of effective management as the basis for resolving conflicts of dual residence. Much income is in fact produced by managerial skills, and it is appropriate that the tax burden of a company be determined more by the substance of its business activities than by an arbitrary choice of a place of incorporation. Nevertheless, not much clarity exists about the meaning of the word 'effective management'. The management contemplated seems to be the highest controlling management of the business of the corporate entity, which is usually exercised by its board of directors. It is not the practical day-to-day management that is considered, but the exercise of the overriding control and the making of policy decisions relating to the business being carried on.

True management in substance and not merely in form is intended. Therefore when the board of directors does not in practice exercise such control and define such policy the board cannot be taken into account, the search for corporate body or office that performs these activities then has to be taken further. The

'effective management' test is followed in the treaties with Germany, Israel, the Netherlands and the United Kingdom.

### 3.5 Conclusion

It may be possible to derive certain tax benefits from the fact that a company is incorporated in South Africa but effectively managed and controlled in the other contracting state, if the following points are considered:

- The importance attached by the South African tax laws to the place of incorporation of a company.
- The adoption by certain contracting states of income tax legislation using the principle of residence as a basis of taxation. Furthermore, some of these states consider the place of management and control as a determining the residence of companies for tax purposes.
- The inclusion in a particular treaty of the rule solving conflicts of corporate residence by giving preference to the contracting state in which the effective management of a company is located.
- The rules of allocation adopted for certain items of income, which under certain circumstances give to the state of residence the sole right to tax that type of income.

An illustration of such a benefit will arise when several South African trading subsidiaries of a United Kingdom group are held by an intermediate South African holding company that is effectively managed and controlled in the United Kingdom. Dividends paid by South African trading subsidiaries to the South

African intermediary holding company has been incorporated in South Africa, liability for NRST on the dividends does not arise. In terms of the treaty with the United Kingdom the intermediate holding company is a resident in the United Kingdom, since it is liable for United Kingdom taxation and is effectively managed and controlled in the United Kingdom. Consequently, South Africa is precluded from levying its NRST on the dividends paid by South African intermediate holding company to a United Kingdom company of the United Kingdom Group.

## Chapter 4

### 4.1 CONVENTION BETWEEN THE REPUBLIC OF SOUTH AFRICA AND THE UNITED STATES OF AMERICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS

In terms of section 108(2) of the Income Tax Act, 1962 (Act No 58 of 1962), read in conjunction with section 231(4) of the Constitution of the Republic of South Africa, 1996 (Act No 108 of 1996), it is hereby notified that the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains set out in the Schedule to this Notice has been entered into with the United States of America and has been approved by Parliament in terms of section 231(2) of the Constitution.

### 4.2 CONVENTION BETWEEN THE REPUBLIC OF SOUTH AFRICA AND THE UNITED STATES OF AMERICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS

The Government of the Republic of South Africa and the Government of the United States of America desiring to promote and strengthen the economic relations between the two countries Have agreed as follows:

#### 4.3 General Scope

1. This Convention shall apply only to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention.
2. The Convention shall not restrict in any manner any benefit now or hereafter accorded:
  - a) by the laws of either Contracting State; or
  - b) by any other agreement between the Contracting States.
3. Notwithstanding the provisions of subparagraph 2b):
  - a) the provisions of Article 25 (Mutual Agreement Procedure) of this Convention exclusively shall apply to any dispute concerning whether a measure is within the scope of this Convention, and the procedures under this Convention exclusively shall apply to that dispute; and
  - b) unless the competent authorities determine that a taxation measure is not within the scope of this Convention, the non-discrimination obligations of this Convention exclusively shall apply with respect to that measure, except for Such national treatment or most-favoured-nation obligations as may apply to Trade in goods under the General Agreement on Tariffs and Trade. No national treatment or most-favoured-nation obligation under any other agreement shall apply with respect to that measure.
  - c) For the purpose of this paragraph, a "measure" is a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.
3. Notwithstanding any provision of the Convention except paragraph 5, the United States may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if the Convention had not come into effect. For this purpose, the term "citizen" shall include a former citizen or long-term resident whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under the laws of the United States), but only for a period of ten years following such loss.

#### **4.4 Taxes Covered**

1. The existing taxes to which the Convention shall apply are in particular:
- a) in the United States: the Federal income taxes imposed by the Internal Revenue Code of 1986 (but excluding social security taxes), and the Federal excise taxes imposed with respect to private foundations; (hereinafter referred to as "United States tax");
  - b) in South Africa:
    - i) the normal tax;
    - ii) the secondary tax on companies; (hereinafter referred to as "South African tax").
2. This Convention shall also apply to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their respective taxation laws or other laws affecting their obligations under the Convention, and of any official published material concerning the application of the Convention, including explanations, regulations, rulings, or judicial decisions.

#### 4.5 General Definitions

1. In this Convention, unless the context otherwise requires:
- a) i) the term "United States" means the United States of America; and
  - ii) when used in a geographical sense, the term "United States" means the States thereof and the District of Columbia. Such term also includes:
    - aa) the territorial sea thereof;
    - bb) the seabed and subsoil of the adjacent submarine areas beyond the territorial sea over which the United States exercises sovereign rights in accordance with international law for the purpose of exploration and exploitation of the natural resources of such areas, but only to the extent that the person, property or activity to which this Convention is being applied is connected with such exploration or exploitation;

b) the term "South Africa" means the 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 hereafter 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;

c) the term "person" includes an individual, an estate, a trust, a partnership, a company and any other body of persons;

d) the term "company" means any body corporate or any entity which is treated as a company or body corporate for tax purposes according to the laws of the Contracting State in which it is organised;

e) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

f) the term "nationals" means all individuals having the citizenship of a Contracting State and all legal persons, partnerships, associations and other entities deriving their status as such from the laws in force in a Contracting State;

g) the term "competent authority" means:

i) in the case of the United States, the Secretary of the Treasury or his delegate; and

ii) in the case of South Africa, the Commissioner for Inland Revenue or his authorised representative;

h) the term "international traffic" means any transport by a ship or aircraft, except when such transport is solely between places in a Contracting State.

2. As regards the application of this Convention at any time by a Contracting State any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning which it has at



that time under the law of that State concerning the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

#### 4.6 Residence

1. For the purposes of this Convention the term "resident of a Contracting State" means:

a) in the case of the United States,

i) any person who, under the laws of the United States, is liable to tax therein by reason of his domicile, residence, citizenship, place of incorporation, or any other criterion of a similar nature, provided, however, that this term does not include any person who is liable to tax in the United States in respect only of income from sources therein or of profits attributable to a permanent establishment in the United States; and

ii) a legal person organised under the laws of the United States and that is generally exempt from tax in the United States and is established and maintained in the United States either:

aa) exclusively for a religious, charitable, educational, scientific, or other similar purpose; or

bb) to provide pensions or other similar benefits to employees pursuant to a plan;

b) in the case of South Africa, any individual who is ordinarily resident in South Africa and any legal person which is incorporated or has its place of effective management in South Africa;

c) that State, and any political subdivision or local authority thereof;

d) in the case of an item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State, that income shall be considered to be derived by a resident of a State to the extent that the item

is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);
- b) if the State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
- d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which it is incorporated.

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Convention to such person.

#### 4.7 Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

a) a place of management;

b) a branch;

c) an office;

d) a factory;

e) a workshop;

f) a mine, an oil or gas well, a quarry or other place of extraction of natural resources;

g) a warehouse, in relation to a person providing storage facilities for others;

h) a store or premises used as a sales outlet;

i) a ship, drilling rig, installation or other structure used for the exploration or exploitation of natural resources, but only if it lasts more than twelve months;

j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities lasts more than twelve months; and

k) the furnishing of services, including consultancy services, within a Contracting State by an enterprise through employees or other personnel engaged by the enterprise for such purposes, but only if activities of that nature continue (for the same or a connected project) within that State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the taxable year concerned.

3. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
  - c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
  - d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
  - e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- and
- f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e).

4. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 5 applies - is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other Contracting State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company that is a resident of the other Contracting State, or

that carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company as a permanent establishment of the other.

#### **4.8 Income from Immovable Property (Real Property)**

1. Income derived by a resident of a Contracting State from immovable property (real property), including income from agriculture or forestry, situated in the other Contracting State may be taxed in that other State.
2. The term "immovable property (real property)" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Ships, boats and aircraft shall not be regarded as immovable property.
3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting or use in any other form of immovable property.
4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

#### **4.9 Business Profits**

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the

other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.
3. In the determination of the profits of a permanent establishment, there shall be
4. allowed as deductions expenses which are incurred for the purposes of the permanent establishment including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses so incurred, whether in the Contracting State in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts, if any, incurred (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by
5. way of commission or other charges for specific services performed or for management or by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than towards reimbursement of actual expenses), by the permanent establishment
6. to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission or other charges for specific services performed or for management or by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
5. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.
6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good reason to the contrary.
7. In applying paragraphs 1 and 2 of Article 7 (Business Profits), paragraphs 4 and 6 of Article 10 (Dividends), paragraph 3 of Article 11 (Interest), paragraph 3 of Article 12 (Royalties), paragraph 3 of Article 13 (Capital Gains), Article 14 (Independent Personal Services) and paragraph 2 of Article 21 (Other Income), any income or gain attributable to a permanent establishment or fixed base during its existence is taxable in the Contracting State where such permanent establishment or fixed base is situated even if the payments are deferred until such permanent establishment or fixed base has ceased to exist.

#### 4.10 Shipping and Air Transport

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.
2. For the purposes of this Article, profits from the operation of ships or aircraft in international traffic include profits derived from the rental of ships or aircraft if such ships or aircraft are operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph 1.
3. Profits of an enterprise of a Contracting State from the use or rental of containers (including trailers, barges and related equipment for the transport of containers) used in international traffic shall be taxable only in that State.

4. The provisions of paragraphs 1 and 3 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

#### 4.11 Associated Enterprises

1. Where:

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly - profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits if it agrees with the adjustment made by the first-mentioned State. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.



#### **4.12 Dividends**

1. Dividends paid by a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other Contracting State.

2. However, such dividends may also be taxed in the Contracting State of which the payer is a resident, and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 10 per cent of the voting stock of the company paying the dividends; and

b) 15 per cent of the gross amount of the dividends in all other cases.

The provisions of this paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Subparagraph a)

shall not apply in the case of dividends paid by a United States person that is a Regulated Investment Company or a Real Estate Investment Trust.

Subparagraph b)

shall apply in the case of dividends paid by a Regulated Investment Company. In the case of dividends paid by a Real Estate Investment Trust, subparagraph b) shall apply only if the dividend is beneficially owned by an individual holding a less than 10 percent interest in the Real Estate Investment Trust; otherwise, the rate of withholding applicable under domestic law shall apply.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income that is subjected to the same taxation treatment as income from shares under the laws of the State of which the payor is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the

other Contracting State of which the payor is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the dividends are attributable to such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

5. Where a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by that resident except in so far as such dividends are paid to a resident of that other State or in so far as the dividends are attributable to a permanent establishment or a fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in such other State.

6. A company that is a resident of one of the Contracting States and that has a permanent establishment in the other Contracting State or, if the United States is the other Contracting State, that is subject to tax in the United States on a net basis on its income that may be taxed there under Article 6 (Income from Immovable Property (Real Property)) or under paragraph 1 of Article 13 (Capital Gains), may be subject in the other Contracting State to a tax, but;

a) in the case of the United States, such tax may not exceed, in addition to the tax on profits, 5 percent of the portion of the profits of the corporation subject to tax in the United States that represents the dividend equivalent amount of such profits; and

b) in the case of South Africa, such tax may be imposed at a rate that does not exceed the normal rate of corporate tax by more than 5 percentage points.

7. The term "dividend equivalent amount" as used in paragraph 6, refers to the portion of the profits of a permanent establishment subject to a tax under Article 7 (Business Profits), or that portion of the profits of a resident of one State subject to tax on a net basis in the other State under Article 6 (Income from

Immovable Property (Real Property)) or under paragraph 1 of Article 13 (Capital Gains), that is comparable to the amount that would be distributed as a dividend if such income were earned by a locally incorporated subsidiary. The term "dividend equivalent amount" shall have the same meaning that it has under the law of the United States as it may be amended from time to time without changing the general principle of this paragraph.

8. Notwithstanding paragraph 2, dividends may not be taxed in the Contracting State of which the payor is a resident if the beneficial owner of the dividends is:

- a) a Contracting State, and any political subdivision or local authority thereof; or
- b) a pension trust or fund of an entity described in subparagraph a) that is constituted and operated exclusively to administer or provide pension benefits described in Article 19 (Government Service) and that does not control the payor of the dividend.

#### **4.13 Interest**

1. Interest derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "interest" as used in this Convention means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits and, in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures, and all other income that is subjected to the same taxation treatment as income from money lent by the taxation law of the Contracting State in which the income arises. Income dealt with in Article 10 (Dividends) and penalty charges for late payment shall not be regarded as interest for the purposes of this Convention.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent

establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the interest is attributable to such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Where, by reason of a special relationship between the payor and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payor and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

5. Notwithstanding the provisions of paragraph 1:

- a) interest that is contingent interest of a type that does not qualify as portfolio interest under United States law may be taxed at a rate not exceeding the rate prescribed in subparagraph b) of paragraph 2 of Article 10 (Dividends); and
- b) interest that is an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit may be taxed by the United States in accordance with its domestic law.

#### 4.14 Royalties

1. Royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "royalties" as used in this Convention means:

- a) any consideration for the use of, or the right to use, any copyright of literary, artistic, scientific or other work (including computer software, cinematographic films, audio or video tapes or disks, and other means of image or sound reproduction), any patent, trade mark, design or model, plan, secret formula or

process, or other like right or property, or for information concerning industrial, commercial, or scientific experience; and

b) gain derived from the alienation of any property described in subparagraph a), provided that such gain is contingent on the productivity, use, or disposition of the property.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties are attributable to such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Where, by reason of a special relationship between the payor and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payor and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

#### 4.15 Capital Gains

1. Gains derived by a resident of a Contracting State that are attributable to the alienation of real property situated in the other Contracting State may be taxed in that other State.

2. For the purposes of this Convention the term "real property situated in the other Contracting State" shall include:

a) real property referred to in Article 6 (Income from Immovable Property (Real Property));

b) a United States real property interest; and

c) an equivalent interest in real property situated in South Africa.

3. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

4. Gains of an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated in international traffic or movable property pertaining to the operation of such ships, aircraft or containers, shall be taxable only in that State.

5. Gains from the alienation of any property other than that referred to in the preceding paragraphs shall be taxable only in the Contracting State of which the alienator is a resident.

#### 4.16 Independent Personal Services

Income derived by an individual who is a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State unless such services are performed in the other Contracting State and such individual has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other State but only so much of it as is attributable to that fixed base. For the purposes of this Convention, where an individual who is a resident of a Contracting State stays in the other Contracting State for a period or periods exceeding in the aggregate

183 days in any twelve-month period commencing or ending in the fiscal year concerned, he shall be deemed to have a fixed base regularly available to him in that other State and the income that is derived from his activities that are performed in that other State shall be attributable to that fixed base.

#### 4.17 Dependent Personal Services

1. Subject to the provisions of Articles 16 (Directors' Fees), 18 (Pensions and Annuities) and 19 (Government Service), salaries, wages and other remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised such remuneration as is derived there from may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

- a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
- b) the remuneration is paid by or on behalf of an employer who is not a resident of the other State; and
- c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment as a member of the complement of a ship or aircraft operated in international traffic may be taxed only in that State.

#### 4.18 Directors' Fees

Directors' fees and other remuneration derived by a resident of a Contracting State for services rendered in the other Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

#### 4.19 Entertainers and Sportsmen

1. Income derived by a resident of a Contracting State as an entertainer such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsman, from his personal activities as such exercised in the other Contracting State, which income would not be liable to tax in that other Contracting State under the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services) and 15 (Dependent Personal Services), may be taxed in that other State except where the amount of the gross receipts derived by such entertainer or sportsman from such activities, including expenses reimbursed to him or borne on his behalf, does not exceed seven thousand five hundred United States dollars (\$7,500) or its equivalent in South African rand for the taxable year concerned.

2. Where income in respect of personal activities exercised by an entertainer or a sportsman in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services) and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or sportsman are exercised, unless it is established that neither the entertainer or sportsman nor persons related to such entertainer or sportsman participate directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

3. Income referred to in the preceding paragraphs of this Article, derived by a resident of a Contracting State in respect of activities exercised in the other



Contracting State, shall not be taxed in that other State if the visit of the entertainers or sportsmen to that other State is supported wholly or mainly from the public funds of the Government of the first-mentioned State or of a political subdivision or local authority thereof.

4. The Contracting States may, through the exchange of diplomatic notes agree to increase the amount referred to in paragraph 1 to reflect economic or monetary developments.

#### 4.20 Pensions and Annuities

1. Subject to the provisions of Article 19 (Government Service), pension distributions and other similar remuneration derived from sources within a Contracting State and beneficially owned by a resident of the other Contracting State, whether paid periodically or as a single sum, may be taxed by the first-mentioned State under the following conditions:

a) where the United States is the first-mentioned Contracting State, the tax imposed on the pension or similar remuneration may not exceed 15 percent of the gross amount of the pension or similar remuneration, provided that such pension or similar remuneration is not subject to a penalty for early withdrawal; and

b) where South Africa is the first-mentioned Contracting State:

i) the beneficial owner of the pension or similar remuneration has been employed in South Africa for a period or periods aggregating two years or more during the ten year period immediately preceding the date from which the pension first became due; and

ii) the beneficial owner of the pension or similar remuneration was employed in South Africa for a period or periods aggregating ten years or more.

2. Notwithstanding paragraph 1 of this Article and paragraph 2b) of Article 19

(Government Service), social security benefits and other similar public pensions paid by a Contracting State to a resident of the other Contracting State or to a citizen of the United States shall be taxable only in the first-mentioned State.

3. Annuities beneficially derived by a resident of a Contracting State shall be taxable only in that State unless the annuity was purchased in the other Contracting State while such person was a resident of that other State, in which case the annuity may also be taxed in that other State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

4. Alimony paid by a resident of a Contracting State, and deductible therein, to a resident of the other Contracting State shall be taxable only in the first-mentioned State. Alimony paid by a resident of a Contracting State, and not deductible therein, to a resident of the other Contracting State shall be exempt from tax in both States. The term "alimony" as used in this paragraph means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance or compulsory support.

5. Periodic payments, not dealt with in paragraph 4, for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance or compulsory support, paid by a resident of a Contracting State to a resident of the other Contracting State, and not deductible in the first-mentioned State, shall be exempt from tax in both Contracting States.

6. For purposes of this Convention, where an individual who is a participant in a pension plan that is established and recognized under the legislation of one of the Contracting States performs personal services in the other Contracting State:

a) Contributions paid by or on behalf of the individual to the plan during the period that he performs such services in the other State shall be deductible (or excludible) in computing his taxable income in that State. Any benefits accrued

under the plan or payments made to the plan by or on behalf of his employer during that period shall not be treated as part of the employee's taxable income and shall be allowed as a deduction in computing the profits of his employer in that other State.

b) Income earned but not distributed by the plan shall not be taxable in the other State until such time and to the extent that a distribution is made from the plan.

c) Distributions from the plan to the individual shall not be subject to taxation in the other Contracting State if the individual contributes such amounts to a similar plan established in the other State within a time period and in accordance with any other requirements imposed under the laws of the other State.

d) The provisions of this paragraph shall not apply unless:

i) contributions by or on behalf of the individual to the plan (or to another similar plan for which this plan was substituted) were made before he arrived in the other State; and

ii) the competent authority of the other State has agreed that the pension plan generally corresponds to a pension plan recognized for tax purposes by that State.

The benefits granted under this paragraph shall not exceed the benefits that would be allowed by the other State to its residents for contributions to, or benefits otherwise accrued under a pension plan recognized for tax purposes by the other State.

7. For the purposes of this Convention, a pension or similar remuneration is deemed to arise from sources within a Contracting State to the extent that the pensionable service to which it relates is performed in that State.

#### 4.21 Government Service

1. a) Remuneration, other than a pension, paid by, or out of funds created by, a

Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority thereof, shall be taxable only in that State.

b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident of that other State who:

i) is a national of that other State; or

ii) did not become a resident of that other State solely for the purpose of rendering the services.

2. a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority thereof, shall be taxable only in that State.

b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. The provisions of this Article shall not apply to payments in respect of services rendered in connection with any trade or business carried on by either of the Contracting States, a political subdivision or a local authority thereof.

#### 4.22 Students, Apprentices and Business Trainees

A student, apprentice or business trainee who is present in a Contracting State for the purpose of his full-time education or training and who is, or immediately before being so present was, a resident of the other Contracting State, shall be exempt from tax in the first-mentioned State on payments which arise from sources outside that first-mentioned State for the purposes of his maintenance, education or training. The exemption from tax provided by this Article shall apply to an apprentice or trainee for a period of time not exceeding one year from the date he first arrives in the first-mentioned Contracting State for the purpose of his apprenticeship or training.

#### 4.23 Other Income

1. Items of income beneficially owned by a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.
2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6 (Income from Immovable Property (Real Property)), if the beneficial owner of the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the income is attributable to such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

#### 4.24 Limitation on Benefits

1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article.
2. A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is:
  - a) an individual;
  - b) a Contracting State, political subdivision or local authority thereof;
  - c) a company, if:
    - i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or

- ii) at least 50 percent of each class of shares in the company is owned directly or indirectly by companies entitled to benefits under clause i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to the benefits of the Convention under this paragraph;
- d) a legal person organized under the laws of a Contracting State that is generally exempt from tax in that State under laws relating to charitable and other similar organizations;
- e) a legal person organized under the laws of a Contracting State that is generally exempt from tax in that State, and is established and maintained in that State to provide pensions or other similar benefits to employees pursuant to a plan, provided that more than 50 percent of the beneficiaries, members or participants are individuals resident in either Contracting State;
- f) a person other than an individual or a trust, if:
  - i) on at least half the days of the taxable year persons described in subparagraphs a), b), c), d) or e) own, directly or indirectly (through a chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 50 percent of each class of shares or other beneficial interests in the person, and
  - ii) less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the person's State of residence;
- g) a trust, if:
  - i) on at least 274 days of the taxable year persons described in subparagraphs a), b), c), d), e) or f) own, directly or indirectly (through a chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 80 percent of the aggregate

beneficial interests in the trust, and

ii) less than 50 percent of the trust's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the trust's State of residence.

3. a) A resident of a Contracting State not otherwise entitled to benefits shall be entitled to the benefits of this Convention with respect to an item of income derived from the other State, if:

i) the resident is engaged in the active conduct of a trade or business in the first-mentioned State,

ii) the income is connected with or incidental to the trade or business, and

iii) the trade or business is substantial in relation to the activity of the resident (and any related parties) in the other State generating the income.

b) For purposes of this paragraph, the business of making or managing investments will not be considered an active trade or business unless the activity is banking, insurance or securities activity conducted by a bank, insurance company or registered securities dealer, respectively.

c) Whether a trade or business is substantial for purposes of this paragraph will be determined based on all the facts and circumstances. In any case, however, a trade or business will be deemed substantial if, for the preceding taxable year, or for the average of the three preceding taxable years, the asset value, the gross income, and the payroll expense that are related to the trade or business in the first-mentioned State equal at least 7.5 percent of the resident's (and any related parties') proportionate share of the asset value, gross income and payroll expense, respectively, that are related to the activity that generated the income in the other State, and the average of the three ratios exceeds 10 percent.

d) Income is derived in connection with a trade or business if the activity in the other State generating the income is a line of business that forms a part of or is

complementary to the trade or business. Income is incidental to a trade or business if it facilitates the conduct of the trade or business in the other State.

4. A resident of a Contracting State not otherwise entitled to benefits may be granted benefits of the Convention if the competent authority of the State from which benefits are claimed so determines.

5. For purposes of this Article the term "recognized stock exchange" means:

a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;

b) the Johannesburg Stock Exchange; and

c) any other exchange agreed upon by the competent authorities of the Contracting States.

6. Notwithstanding the other provisions of this Convention:

a) where an enterprise of South Africa derives income from the United States;

b) that income is attributable to a permanent establishment which that enterprise has in a third jurisdiction; and

c) the enterprise is not liable to tax in South Africa on the profits attributable to the permanent establishment; the United States tax benefits that otherwise would apply under the other provisions of this Convention will not apply to any item of income on which the combined tax in South Africa and in the third jurisdiction is less than 50 percent of the tax that would be imposed in South Africa if the income were earned by the South African enterprise and were not attributable to the permanent establishment in the third jurisdiction. Any interest or royalties to which this paragraph applies will be subject to United States tax at a rate not exceeding 15 percent of the gross amount thereof. The preceding sentences of this paragraph shall not apply:

a) to interest derived in connection with or incidental to the active conduct of a trade or business carried on by the permanent establishment in the third



jurisdiction (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company, respectively);

b) to royalties that are received as a compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; and

c) to income derived by an enterprise of South Africa if the United States taxes the profits of such enterprise according to the provisions of subpart F of part III of subchapter N of chapter 1 of subtitle A of the Internal Revenue Code of 1986, as it may be amended from time to time without changing the general principle thereof.

#### 4.25 Elimination of Double Taxation

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or a citizen of the United States as a credit against the United States tax on income:

a) the South African tax paid or accrued by or on behalf of such citizen or resident; and

b) in the case of a United States company owning at least 10 per cent of the voting stock of a company which is a resident of South Africa and from which the United States company receives dividends, the South African income tax paid by or on behalf of the distributing company with respect to the profits out of which the dividends are paid.

2. Where a United States citizen is a resident of South Africa:

a) with respect to items of income that under the provisions of this Convention are exempt from United States tax or that are subject to a reduced rate of United States tax when derived by a resident of South Africa who is not a United States citizen, South Africa shall allow as a credit against South African tax, only the

tax paid, if any, that the United States may impose under the provisions of this Convention, other than taxes that may be imposed solely by reason of citizenship under the saving clause of paragraph 4 of Article 1 (General Scope);

b) for purposes of computing United States tax on those items of income referred to in subparagraph a), the United States shall allow as a credit against United States tax the income tax paid to South Africa after the credit referred to in subparagraph a); the credit so allowed shall not reduce the portion of the United States tax that is creditable against the South African tax in accordance with subparagraph a); and

c) for the exclusive purpose of relieving double taxation in the United States under subparagraph b), items of income referred to in subparagraph a) shall be deemed to arise in South Africa to the extent necessary to avoid double taxation of such income under subparagraph b).

3. United States taxes paid by South African residents in respect of income taxable in the United States, in accordance with the provisions of this Convention, other than taxes that may be imposed solely by reason of citizenship under paragraph 4 of Article 1 (General Scope), shall be deducted from the South African taxes due according to South African fiscal law. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income taxable in South Africa.

#### 4.26 Non-discrimination

1. The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances

are or may be subjected. This provision shall, notwithstanding the provisions of Article 1 (General Scope), also apply to persons who are not residents of one or both of the Contracting States. However, for the purposes of United States taxation, United States nationals who are subject to tax on a worldwide basis are not in the same circumstances as South African nationals who are not residents of the United States.

2. The taxation on a permanent establishment or fixed base that a resident or enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises or residents of that other State carrying on the same activities.
3. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.
4. Nothing in this Article shall be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.
5. Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest) or paragraph 4 of Article 12 (Royalties) apply, interest, royalties and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.

6. Nothing in this Article shall be construed as preventing either Contracting State from imposing a tax as described in paragraph 6 of Article 10 (Dividends).
7. The provisions of this Article shall, notwithstanding the provisions of Article 2 (Taxes Covered), apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

#### 4.27 Mutual Agreement Procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of this Convention (or in the case of tax collected at source within three years from
2. the date of collection).
3. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.
4. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Convention. They may also consult

together for the elimination of double taxation in cases not provided for in this Convention.

5. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.
  
6. In particular the competent authorities of the Contracting States may agree:
  - a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;
  - b) to the same allocation of income, deductions, credits, or allowances between persons;
  - c) to the same characterization of particular items of income;
  - d) to the same characterization of persons;
  - e) to the same application of source rules with respect to particular items of income; and
  - f) to a common meaning of a term.

#### **4.28 Exchange of Information and Administrative Assistance**

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention

or of the domestic laws of the Contracting States concerning taxes covered by this Convention in so far as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1 (General Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by this Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:
  - a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
  - b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
  - c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).
3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts and

writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of that other State with respect to its own taxes.

4. Each of the Contracting States shall endeavour to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the Convention from taxation imposed by that other State does not inure to the benefit of persons not entitled thereto.
5. Paragraph 4 of this Article shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own taxes, or which would be contrary to its sovereignty, security or public policy.
6. For the purposes of this Article, the Convention shall apply, notwithstanding the provisions of Article 2 (Taxes Covered), to taxes of every kind administered by the competent authorities (but not including customs duties).
7. The competent authority of the requested State shall allow representatives of the applicant State to enter the requested State to interview individuals and examine books and records with the consent of the persons subject to examination.

#### 4.29 Diplomatic Agents and Consular Officers

Nothing in this Convention shall affect the fiscal privileges of members of diplomatic missions or consular posts under the general rules of international law or under the provisions of special agreements.

#### 4.30 Entry into Force

1. The Contracting States shall notify each other that the constitutional requirements for the entry into force of this Convention have been complied with.

2. This Convention shall enter into force thirty days after the date of the later of the notifications referred to in paragraph 1 and its provisions shall apply:
  - a) with regard to taxes withheld at source, in respect of amounts paid or credited on or after the first day of January next following the date upon which the Convention enters into force; and
  - b) with regard to other taxes, in respect of taxable periods beginning on or after the first day of January next following the date upon which the Convention enters into force.

#### 4.31 Conclusion

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention by giving notice of termination, through the diplomatic channel, at least six months before the end of any calendar year starting five years after the year in which the Convention entered into force. In such event, the Convention shall cease to have effect, with regard to taxes withheld at source, in respect of amounts paid or credited on or after the first day of January next following the year in which the notice is given; and with regard to other taxes, in respect of taxable periods beginning on or after the first day of January next following the year in which the notice is given.



## Chapter 5 (Conclusion)

### Anti-avoidance – Pricing and General Provision

#### 5.1 Pricing

Apart from a specific provision connected with the application of the treaties, the South African tax laws do not include any specific provision allowing the imputation of income based merely on the fact that 'non-arm's-length' transactions have taken place. Consequently, for example, no interest, fees or royalties may be allocated to enterprises that lend money or provide credit facilities at interest free rates or conclude license or management agreements without charging any royalties or fees. The Revenue authorities are not entitled to impute taxable income to a selling company merely because this enterprise sells goods below their cost to a related company. In the same way, rental income cannot be imputed to the owner of movable or immovable property merely because he has allowed another person the free use of that property.

The Revenue authorities may, however, disallow the deduction of expenses that do not comply with the requirements for their deductibility. For example, the deduction of interest incurred on capital obtained that has been subsequently lent at interest-free rates or at lower rates of interest may be disallowed. The same principle applies to expenses incurred by the enterprise in order to provide free services or to produce goods that are then sold below cost. Another example arises with the disallowance of the deduction of expenses incurred on a 'non-arms'-length' basis, that is, expenses that are considered as being excessive. It seems that the basis on which these illustrative disallowances occur is that such excessive expenses are not incurred in the production of income but with some other motive. When a tax disallowance of the excessive expenses takes place the Revenue authorities are not obliged to decrease in the same proportion the

profits of the enterprise that acquired the services or goods. Accordingly, economic double taxation may occur. Finally, the deduction of expenses incurred outside South Africa is left to the discretion of the tax authorities. In practice, provided the foreign expenses are reasonable and fulfil the general requirements of having been incurred in the production of 'income' (which excludes foreign income or exempt income) and not being of a capital nature, the Revenue authorities exercise their discretion in favour of the enterprise. Most of the foreign expenses, such as interest or royalties, require the prior approval of the South African exchange-control authorities, who have to be satisfied with their reasonableness. When their approval is required and has been obtained the Revenue authorities tend to accept the expenses as being reasonable. A specific problem arises when the enterprise has not obtained the required prior approval of the exchange-control authorities for incurring the liability to a non-resident but has nevertheless concluded the relevant agreement. It is debatable whether the expense is incurred and should therefore be allowed as a deduction for tax purposes. In practice the Revenue authorities do not accept the deduction of foreign expenses for which exchange-control approval was required and has not been granted.

## 5.2 Deemed accrual or receipt of income

A general statutory deeming provision exists preventing a taxpayer from avoiding tax by ceding his rights to income or enjoyment but still keeping ownership or an interest in the property producing income. This provision is confined to certain types of income, and applies under specified circumstances. Only income that has been accrued to or has been received by or for the benefit of another person may be deemed to be income of the taxpayer and taxed accordingly. The types of income covered include rent, dividends, interest, royalties, similar income in

respect of immovable or movable property and income in respect of the use of or the granting of permission to use such property. In very broad terms, the circumstances giving rise to the imputation of the income to the taxpayer refer to the gratuitous disposition of his right to receive or have paid to him or for his benefit that income while he remains the owner of the property in question or retains an interest in that property or, within a fixed or determined time, is entitled to regain ownership of or the interest in the property.

For example, if the taxpayer allows another person the use of his immovable property for no consideration, any rental income accruing to or received by that person from letting the property is deemed to be income of the taxpayer. This provision has no application in situations where no income accrues to or is received by or for the benefit of the person using the property. The person receiving the income, to whom the income accrues or for whose benefit the income accrues or is received is not subjected to taxation on that income, since the law deems the receipt or accrual as having taken place in the hands of the taxpayer. Such a person will therefore also not be allowed any deductions for expenses incurred in earning the income. The law, however, does not deem any possible expenses incurred by that person in order to earn the income as having been incurred by the taxpayer. It seems that economic double taxation may arise, since neither the person who incurred the expenses nor the person to whom the income is deemed to have accrued is able to claim a deduction for such expenses.

### 5.3 General provision

The South African tax law includes a general anti-avoidance provision aimed at transaction, operations or schemes resulting in the avoidance, reduction or postponement of payment of tax. As long as the business normality of a

transaction, operation or scheme or its 'arm's length' principle is proved by the taxpayer, the provision becomes ineffective. The provision also cannot be applied if it is proved by the taxpayer that the sole or main purpose of the transaction, operation or scheme was not the avoidance, reduction or postponement of tax. The remedies of the Revenue authorities for transactions that become the targets of the general anti-avoidance provision are somewhat unclear. The law empowers them to ignore the transaction, operation or scheme when determining the liability for tax of the parties involved or to consider the existence of the transaction, operation or scheme, but modified in an appropriate way to prevent or reduce the avoidance, reduction or postponement of tax.

The Revenue authorities may not create obligations or rights between parties but may impute income to a person who has not received it or to whom it has not accrued if, for example, such income was received by or accrued to some other person by arrangement with the taxpayer under assessment. It is submitted that only 'amounts received or accrued' may be allocated between the parties. The parties cannot be subjected to tax on non-existent sums or income which on an arm's-length transaction should have accrued or been received.

#### 5.4 The Commentaries on the Articles of the OECD Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital

Under the auspices of the League of Nations two important model conventions concerning the avoidance of double taxation on income and property were adopted – the convention of Mexico (1943), and the convention of London (1946). The League of Nations wished to find principles and establish rules for the determination of taxing rights throughout the entire world. The participants to

the meeting of the League of Nations were independent experts. The Organization for European Economic Co-operation (OEEC) was created in 1948 in pursuance of the goal of removing obstacles to international trade and capital movements and of eliminating arbitrary discrimination in international economic relations caused by double taxation. Its Fiscal Committee came into existence by a resolution of the council dated 16 March 1956. later the OEEC was reorganized as the Organizational for Economic Cooperation and Development (OECD). Although it is a European organization, countries such as Canada, Japan and the United States have become full members. South Africa is not a member country of the OECD.

The OECD has adopted the method of unanimous decisions, and it has recourse to recommendations that can be made only if there is unanimity. These recommendations cannot be binding between two countries. In 1963 the Fiscal Committee of the OECD produced its first 'Draft Double Taxation Convention on Income and Capital', which included commentaries interpreting its various articles. All previous recommendations were then replaced by the 1963 recommendation, which called upon the governments of member countries to conform to the draft convention as drawn up by the Fiscal Committee of the OECD. This model and its commentaries were revised in 1977. In particular, the Committee on Fiscal Affairs urged member countries, 'when concluding new bilateral conventions or revising existing bilaterial conventions between them, to conform to the Model Convention, as interpreted by the Commentaries thereto and having regard to the reservations and derogations to the Model Convention, which are contained [in the 1977 report]'.  
It is therefore expected that the interpretation made by national administrations or by national courts of member countries of provisions in bilateral treaties that have been taken from the OECD model will be influenced by the commentaries. It can be assumed that the parties to a treaty that follow the OECD text have

understood that text according to the meanings expressed in the commentaries. They have also adopted the commentaries in the drafting of the OECD text. The OECD models have the character of an intergovernmental compromise among the member countries. In this way they differ from the models of the League of Nations. The participants to the OECD discussions are governmental representatives. The OECD models thus reflect the influence of existing national law and existing tax treaties. To a large extent, the discussions concerning the OECD drafts have had the character of multilateral negotiations.

The 1977 model convention allows a certain degree of flexibility. In certain instances it provides alternative methods or permits the scope of certain provision to be restricted or enlarged by member countries when concluding bilateral treaties. A certain degree of freedom in negotiating the treaty clauses is thus afforded to members. When, in spite of all efforts at compromise, unanimity cannot be reached members have resorted to so-called reservation, which indicates that although their voting in favour of the rule is to be recommended, they reserve their position with respect to that particular point. It has therefore further been argued that the absence of a reservation by a member country or the adoption of a different wording for a specific article constitutes a strong indication that the wording of the specific provision has been accepted as it was interpreted in the commentary applying to that provision. Although South Africa is not a member country, it is submitted that, by adopting the wording of the OECD drafts in its bilateral treaties, it has expressed a presumed intention of adopting the wording as it was interpreted by the commentaries. Furthermore, the treaties analysed here have all been concluded with member countries that in general have accepted the text as interpreted in the commentaries. The commentaries should at least have a persuasive influence in the interpretation of the treaties.

## 5.5 The Concept of Treaty Resident and the South African Principles of Residence

It was established that the concept of a 'resident' in terms of the treaties is important, since it determines the persons who in general may benefit from those treaties. It was also mentioned, in connection with the aims of the South African treaties, that the treaties are drafted mainly on the assumption that countries assert their tax jurisdiction both on 'sourced' items of income and on the worldwide income of their residents. Accordingly, the treaties allocate the right to tax specific items of income between the country of source (situs) and the country of residence, and deal with the method for avoiding double taxation by imposing an obligation on the state of residence to exempt income from a foreign source or to allow a credit for the foreign taxes on that income. The concept of a 'resident' is therefore also important for the application of the treaties, which are directed mainly at avoiding double taxation based on principles of source and residence.

The majority of the South African treaties include rules for solving conflicts of dual residence. Once a taxpayer is deemed to be a resident of only one contracting state the application of the treaty becomes possible. From this analysis it may be concluded that the general prerequisite in ascertaining whether a benefit under a treaty is available is the capacity of a taxpayer to claim residence in one of the contracting states.

## 5.6 Treaties not following the OECD model definition

Only the treaty with the United States does not provide a definition of 'residence'. The treaties with Canada and Sweden, being among the older treaties signed by South Africa, define a 'resident' in South Africa as a person who is ordinarily

resident in South Africa for purposes of South African tax and not ordinarily resident in Canada or not resident in Sweden for purposes of Canadian tax or Swedish tax respectively. While the Canadian treaty considers a company to be resident at the place where its business is managed and controlled, the Swedish treaty regards a company as being resident in the country of its incorporation.

The definition of a 'resident' as included in the treaties with Sweden and Canada require an individual to prove that

- He is ordinarily resident in South Africa; and
- He is not a resident in Sweden or an ordinary resident in Canada.

Although the German treaty has generally been drafted on the basis of the OECD model, its definition of a 'resident' departs from the wording of the model definition. In terms of this treaty a resident of South Africa is a person (other than a company) who is ordinarily resident in South Africa for purposes of South African taxation. The definition in the German treaty further considers a company that is incorporated, managed or controlled in South Africa to be a resident of South Africa. The location of either the management or the control of the company in South Africa is therefore sufficient to make the company resident in South Africa in terms of this treaty. For a company to be resident in South Africa in terms of the Canadian treaty both the management and control of the business of the company must be located in South Africa. It is important to note that the definition of a South African resident in terms of these three treaties (with Canada, Sweden and Germany) does not require the individual or the company to be liable for South African taxation on the basis of residence, place of incorporation or management or control. An individual must merely be ordinarily resident in South Africa for purposes of South African taxation. In other words, the South African domestic tax laws will apply in the determination of the status of his ordinary residence. He is not, however, required to be subject to South



African taxation on the basis of that status. The same principle applies to companies, which, again, are not required to be liable for South African taxation on the basis of their place of incorporation or management or control in order to be resident in South Africa.

## 5.7 Treaties following the OECD model definition

The other South African treaties dealt with here, namely, the treaties with Israel, the Netherlands, Switzerland and the United Kingdom, follow closely the definition of a 'resident' in the OECD model convention. This definition refers to the concept of a resident applicable under the domestic law of the state applying the treaty, provided that in terms of its domestic law the person has a comprehensive liability to tax in that country based on his domicile, residence, place of management or other criterion of a similar nature. The rate of tax imposed by that state is immaterial, as well as the way in which the tax is imposed. As long as the person is liable to tax on the basis referred to in the definition, he will be a resident of that country for the purpose of its treaties. The existence of particular exemptions applicable to certain types of income should also not affect the status of a resident. It seems, however, that if a particular state has adopted a territorial system of taxation, problems may arise in the determination of its 'residents' for purposes of the treaties. It is submitted that to consider a person resident in a country following the territorial system of taxation merely because a company is incorporated or managed and controlled in that state seems somewhat contrary to the definition of a resident included in the treaties that follow the OECD model definition of this term. Despite the existence of a personal attachment to the state applying a territorial basis of taxation, the person concerned may have no liability for tax in that state at all. It is furthermore submitted that taxation based on the source of income cannot be

said to be based on a similar criterion to a tax imposed by reason of the domicile, residence or place of management of a taxpayer. No reference is made to the branch of the domestic law that must apply in the determination of the meaning of the word 'resident'. But, because residence must constitute the basis of taxation, it is assumed that the word refers to the internal tax laws.

Although not laying down specific rules that the domestic tax laws must apply with regard to residence, these treaty provision on residence require that the domestic concept of a resident comply with two general requirements:

- The resident should be subject to a full liability for tax.
- This full liability should arise from a personal attachment, such as domicile or residence, place of management or similar attribute on the part of companies.

The provision of these treaties relating to residence follows the wording of the 1963 OECD model draft convention. The wording is based on the assumption that contracting states assert tax jurisdiction over most items of income arising within their boundaries, as well as jurisdiction to tax the world-wide income of their residents. South Africa, however, in principle does not assert tax jurisdiction based on residence. The 1977 model convention added to the 1963 model definition of a 'resident' the following sentence: 'But this term does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein.' This sentence has not been included in the treaties that were signed by South Africa after the 1977 model. Although the purpose of the inclusion of the sentence seems to be to exclude diplomats (OECD model commentary to art 4 para 8), its literal interpretation might lead to the conclusion that a person can never be treated as a resident of a country within the meaning of a treaty if that country does not tax income from a

foreign source. This may be the reason for its non-inclusion in the treaties signed by South Africa.

Excluded from the concept of a 'resident' in terms of these treaties are persons who are subject to a taxation limited to only certain types of income from sources in a country. Therefore persons subject to only the NRTI or the NRST in South Africa cannot be resident in South Africa for treaty purposes.

The South African normal (income) tax is the only tax that is not limited in the scope of its object, that is, it does not apply to only certain types of income but to all income that is sourced or deemed to be sourced in South Africa. It may be said that the normal tax constitutes a comprehensive tax, since it includes all types of income. Its main basis, however, is not any personal attachment to the country. The concept of domicile is unknown for purposes of South African normal tax. On the other hand, the concepts of residence, place of management or control and place of incorporation have some effect on the imposition of normal tax, but only to a limited extent. They are therefore not defined in the South African statutory provisions. For the same reason, there is little case law on their meaning.

It is further submitted that the withholding tax on royalties, although constituting normal tax paid in advance, should be viewed separately because of its limitation to a certain type of income and its method of computation. The liability for withholding tax on royalties is more closely akin to the NRTI and NRST than to the normal tax, and should therefore follow the regime of the other withholding taxes. In other words, the withholding tax on royalties cannot in itself be regarded as a comprehensive basis of taxation.

The fact that a person is subject to normal tax in South Africa therefore does not necessarily mean that he is a resident in South Africa for purposes of these treaty provisions. A personal attachment of individuals to South Africa needs to be proved, and for companies the place of incorporation or of management or control must be located in South Africa. It is further submitted that the personal attachment to South Africa of an individual consists in his residence in South Africa in terms of the South African tax law. For example, a person resident in a foreign country and deriving sourced business profits from a South African partnership is liable for normal tax but is not resident in South Africa for purposes of these treaty provisions. On the other hand, it is submitted that a person cannot be a resident in South Africa within the meaning of these provisions if he is not liable for normal tax. For example, if a company has been incorporated and is also managed and controlled in South Africa but carries on business exclusively in the Netherlands and thus derives all its income from a foreign source, it is not resident in South Africa for purposes of the treaty with the Netherlands, since it is not liable for a full liability for tax in South Africa. In the same way, an individual may be domiciled and resident in South Africa and yet not liable for normal tax. In principle, he is not entitled to the benefits granted by the South African treaties, which follow the OECD model article on residence.

Although it cannot be said that the treaty concept of residence adopted by South Africa in the majority of its treaties leads to the conclusion that the concept is inapplicable within the context of the South African tax system, the concept does lead to peculiar problems. These problems arise mainly from the fact that the only comprehensive income tax – the normal tax – is imposed on an objective basis: the source of the income. Residence in itself is not a factor determining liability for normal tax in South Africa.

## 5.8 Conclusions on treaty residence

In summary, the conclusions to be drawn from these definitions of a South African resident for purposes of the treaties include the following:

- The South African domestic tax laws apply in the determination of the residence of an individual in all treaties. A South African ordinary resident will have to demonstrate further that he is not resident in Sweden or not ordinarily resident in Canada. No such further specific requirements are imposed in the treaty with Germany. In the remaining treaties, which follow closely the OECD model article on residence, the South African concept of a 'resident' must comply with two additional requirements:
  - The individual must be subject to full liability for tax in South Africa.
  - This liability should arise from a personal attachment to South Africa, such as residence or domicile. It is submitted that the individual should be liable for normal tax in South Africa, although this liability in itself does not suffice. He should also be considered as a resident in terms of South African domestic tax law.
- For companies the treaties that follow the OECD model again accept that the South African domestic tax laws apply in the establishment of corporate residence. They require further that resident companies be liable for full taxation in South Africa based on their residence, management or a similar criterion. It is submitted that for the company to be a South African resident in terms of these treaties it should be liable for normal tax and be incorporated or managed and controlled in South Africa. The treaties with the United States and Sweden determine the residence of a company on the basis of incorporation. The Canadian treaty bases the residence of companies on their place of management and control. Finally, the treaty with Germany

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## **ANNEXURE A**

### **Section 6quat**

Rebate in respect of foreign taxes on income.—(1) Subject to the provisions of subsection (2), there shall be deducted from the normal tax payable by any resident of the Republic or any person contemplated in section 9C (2) (b) or any shareholder who is a "resident" as defined in section 9E, in whose taxable income there is included—

- (a) any income received by or accrued to such resident or person from any country other than the Republic other than any foreign dividend contemplated in paragraph (d); or
- (b) any proportional amount of investment income contemplated in section 9D; or
- (c) any income payable to such resident from the Republic, where such income is deemed to be from a source within the Republic in terms of the provisions of paragraphs (d), (d)bis and ( f ) of section 9 (1); or
- (d) any foreign dividend contemplated in section 9E, a rebate determined in accordance with this section.

(1A) For the purposes of subsection (1), the rebate shall be an amount equal to the sum of any taxes on income proved to be payable, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment), by—

- (a) (i) such resident of the Republic; and  
(ii) any controlled foreign entity, as contemplated in section 9D, in respect of such proportional amount; or
- (b) such person contemplated in section 9C (2) (b); or
- (c) (i) such shareholder in respect of any dividend contemplated in subsection (1) (d); and



- (ii) any company in respect of any profits from which such dividend is declared or deemed to have been declared; or
  - (d) any company in respect of the proportional amount of any profits from which any dividend is declared or deemed to have been declared to a controlled foreign entity and which dividend relates to any proportional amount of investment income included in the income of such shareholder as contemplated in subsection (1) (b), to the government of any country other than the Republic in respect of the amount of income derived from such country, which is so included in that resident's or person's or shareholder's taxable income.
- (1B) Notwithstanding the provisions of subsection (1A)—
- (a) the rebate of any tax proved to be payable to the government of any other country shall not exceed an amount which bears to the total normal tax payable the same ratio as the taxable income attributable to the income derived from such country, which is so included bears to the total taxable income; and
  - (b) where such sum of any taxes payable to the government of any such other country exceeds the rebate as determined in paragraph (a) (hereinafter referred to as the excess amount), such excess amount may—
    - (i) in the case of any excess amount which relates to any amount included in the income of any company as contemplated in paragraph (a), (c) or (d) of subsection (1), be deducted from any Secondary Tax on Companies which becomes payable by such company after the determination of such excess amount, limited to an amount determined by applying the rate of the Secondary Tax on Companies to the profits attributable to the inclusion of the income contemplated in such paragraphs; or
    - (ii) in the case of any excess amount relating to any amount included in the income of any company as contemplated in paragraph (b) of subsection (1), be deducted from any Secondary Tax on

Companies which becomes payable by such company on the distribution of any profits derived by way of dividends declared to such company by such controlled foreign entity from profits that relate to any amount of investment income so included in terms of paragraph (b), limited to an amount determined by applying the rate of the Secondary Tax on Companies to the amount of the taxable income attributable to the inclusion of the income contemplated in such paragraph,  
after the deduction of—

- (aa) any normal tax paid or payable; or
- (bb) such sum of taxes payable to the government of any such other country, whichever amount is the greater:  
Provided that—
  - (A) the amount of any such excess amount as exceeds the amount of any Secondary Tax on Companies as contemplated in subparagraph (i) or (ii), may—
    - (AA) be carried forward to the immediately succeeding year of assessment and shall be deemed to be a tax on income paid to the government of such country in such year; and
    - (BB) be set off against the amount of any normal tax payable by such company during such year of assessment in respect of any amount derived from such country which is included in the taxable income of such shareholder during such year, as contemplated in paragraph (a), (b), (c) or (d) of subsection (1), after any tax payable by such company to the government of such country in respect of the amount so included during such year of assessment has been set off against the amount of—
      - (AAA) such normal tax payable in respect of such amount of income; and
      - (BBB) any Secondary Tax on Companies as contemplated in subparagraph (i) or (ii) which becomes payable during such year; and

- (B) the excess amount contemplated in this paragraph shall not be allowed to be carried forward for more than three years reckoned from the year of assessment when such excess amount was for the first time carried forward;
- (c) the amount of any tax which—
  - (i) becomes payable to the government of any other country in respect of any amount which—
    - (aa) is declared to any company which is a resident as a foreign dividend which is exempt from tax in terms of section 9E (7) (e); or
    - (bb) would, but for the provisions of section 9D (9) ( f ), have been included in any income of such company which is a resident; and
    - (ii) has not been taken into account as a rebate against any normal tax payable by such company in respect of such amount previously included in his taxable income in terms of section 9D, may be deducted from any Secondary Tax on Companies which becomes payable by such company on the distribution of any profits derived by way of dividends declared to such company by any controlled foreign entity from profits relating to any investment income so previously included;
  - (d) no rebate shall be allowed as a deduction from the tax payable by any shareholder, in respect of any tax contemplated in subsection (1A) (c) (ii) or (d), which is payable by—
    - (i) any company distributing any dividend to such shareholder, if such shareholder (in the case of a company, together with any other company in a group of companies of which such company forms part) holds for his or its own benefit less than 10 per cent of the equity share capital in such company; or
    - (ii) any company in respect of any profits from which the dividend is declared or deemed to have been declared, if such shareholder does not hold a qualifying interest in such company;

- (e) no rebate shall be allowed in respect of any tax payable on any amount contemplated in subsection (1) (d), if the shareholder has made an election as contemplated in section 9E (6).
- (2) The rebate under subsection (1) shall not be granted in addition to any relief to which the resident of the Republic is entitled under any agreement between the governments of the Republic and the said other country for the prevention of or relief from double taxation, but may be granted in substitution for the relief to which the resident of the Republic would be so entitled.
- (3) For the purposes of this section—
  - “controlled company” means a controlled company as defined in section 9E;
  - “controlling company” means a controlling company as defined in section 9E;
  - “group of companies” means a group of companies as defined in section 9E;
  - “qualifying interest” means any qualifying interest as defined in section 9E;
  - “resident of the Republic” means—
    - (a) any natural person who is ordinarily resident in the Republic; and
    - (b) any person, other than a natural person, which is incorporated or has its place of effective management in the Republic.

## **ANNEXURE B**

### **Foreign taxes – Proof of payment – Section 6quat**

1. In terms of section 6quat of the Income Tax Act, when determining a taxpayer's tax liability, the taxpayer may, subject to certain provisos, claim a rebate in respect of the foreign taxes paid or payable against South African tax charged in respect of income included in his gross income.
2. In order to claim the rebate in respect of tax paid or payable, the South African resident will have to substantiate the amount of tax paid or payable in the foreign [Page A 342 (2)] country on the income earned during the South African tax year. However, there are practical difficulties in allowing the credit as a result of the difference of tax year ends in the various countries and a self-assessment basis utilised in certain countries.

Until further notice the following guidelines should be followed:

- (1) Where there are different tax years when the taxpayer receives an annual certificate from his bank or financial institution which reflects interest earned during the tax year of the foreign countries, an equal apportionment of the income and tax over the tax year would be acceptable. The appropriate portions can then be allocated to the relevant South African tax year.

The main practical difficulty is the fact that the taxpayer can potentially receive the certificate of earnings several months after the end of the South African tax year. This means that the taxpayer would be obliged to apply for extension of time within which to submit his South African income tax return.

- (2) In terms of section 6quat a rebate in respect of foreign taxes on income must be allowed equal to the sum of any taxes on income proved to be payable, without any right of recovery.
- (3) Adequate proof of payment would be:
  - (1) Where the foreign tax has not been withheld at source: An assessment or receipt issued by the relevant tax authority.

- (2) Where payment of tax has been made to the foreign tax authorities in respect of diverse foreign-sourced income, ie the payment includes payment for foreign tax on both the investment income that is taxable in South Africa in terms of section 9C of the Act and other income that is not taxable in South Africa: The assessment is issued by the relevant tax authority as well as an apportionment on the basis of income taxable in South Africa to the total taxable income in the foreign country.

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- (3) Where the taxpayer is not in receipt of an assessment from the foreign tax authority because the foreign jurisdiction has a self-assessment system: A copy of the tax return submitted to the relevant tax authority would be acceptable.