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Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Master of Philosophy (Tax Law) in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of Master of Philosophy (Tax Law) dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.
# Double Tax Agreements Their Impact, Effect and Relationship with South African Income Tax Law

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DOUBLE TAX TREATIES THEIR AIMS AND OBJECTIVES
The past ten years of a new dispensation have witnessed tremendous changes in every aspect of the lives of all South Africans. This transformation, arguably, could not have not been more wide felt than in the upliftment of social and economic development a process which itself could only have been made possible by an increase in the trading activities of South African business at an international level and of the establishment/re establishment of international businesses into the domestic economy.

From a tax perspective the effects of any international trading activity must result in the requirement for any sovereign state to conform to international standards in its fiscal legislation and in particular the harmonisation of the domestic tax laws with that of international law although recognising at the same time its own sovereignty on the collection of taxes from within its own jurisdiction. It is noteworthy that of all the South African double tax treaties either fully ratified, signed but not yet ratified or under negotiation, approximately 75% have been entered into post the 1994 elections.

Whilst every Sovereign state has the right to impose taxes from economic activity within its territorial boundaries difficulties may arise where conflicting interpretations are placed as to the taxing rights of a state on income as determined by the residence or sourced base principles adopted by either State. For example, where a European company sells its products or services within the territory of the Republic, which State has the right for imposing income tax on the profits derived from those sales, the European State of which the taxpayer is a resident or the South African fiscus in which territory the profits were realised. In the absence of any agreed protocol the problems that could arise through conflict leading to the negative consequences in trade and commerce for both States and their economic development could hardly be emphasised.

This potential taxing of the same income by two or more States is referred to as Juridical Double Taxation in contrast to Economic Double Taxation where the same amount is taxed more than once in the hands of different parties either by a single or multiple states. For example where the profits of a company are taxed and any subsequent dividends then also taxed in the hands of the recipient.
To emphasis the matter the Commentaries to the OECD\textsuperscript{1} Model Tax Convention on Income and on Capital reads:\textsuperscript{2}

> International juridical double taxation can generally be defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods. Its harmful effects on the exchange of goods and services and movement of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries.

To quote A McKie at the 22\textsuperscript{nd} Tax Conference of the Canadian Tax Foundation\textsuperscript{3}

> The Purpose of Double Tax Conventions

> “The taxpayer hopes the treaty will prevent the double taxation of his income; the tax gatherer hopes the treaty will prevent fiscal evasion; and the politician just hopes.”

The development of double tax conventions\textsuperscript{4} began during the later part of the nineteenth century when treaties were first entered into between closely allied states, e.g. Prussia and Saxony 1869, Austria and Hungary circa 1869 and Austria and Prussia circa 1899. Following the First World War an extensive network of double tax treaties then developed in central Europe. The efforts of the League of Nations circa 1921 contributed substantially to an assimilation of the existing bilateral treaties and to the development of uniform model treaties. The increasing economic interdependence and cooperation of the Member countries of the OEEC (Organisation for European Economic Co-operation) in the post war period showed increasingly clearly the importance of measures for preventing international double taxation. The need was recognised for extending the network of bilateral tax conventions to all member countries of the OEEC and subsequently of the OECD\textsuperscript{5} several of which had so far concluded only very few conventions and some non-at all. At the same time harmonisation of these conventions in accordance with uniform principles, definitions, rules and methods and agreement on a common interpretation became increasingly desirable.\textsuperscript{6}

Drawing on the research work of the League of Nations the Committee on Fiscal Affairs (formed during 1956) of the OEEC submitted a series of model treaty articles in four interim reports between 1956 and 1961 and a summary report in 1963 to which the complete model treaty (the OECD MC) and an official commentary were appended.\textsuperscript{7}

\textsuperscript{1} Organisation for Economic Co-operation and Development
\textsuperscript{2} OECD Model Tax Convention on Income and on Capital [2003] – Commentaries Introduction paragraph 1
\textsuperscript{4} Also referred to as ‘Double Tax Treaties’
\textsuperscript{5} The change of name from OEEC to Organisation for Co-operation and Development “OECD” became effective as from September 1961
\textsuperscript{6} OECD Model Tax Convention on Income and on Capital [2003] – Commentaries Introduction paragraph 5
\textsuperscript{7} For a more extensive background on the development work of the development of Double Tax Treaties refer Klaus Vogel ‘Double Tax Conventions – Double Tax and its Avoidance - Introduction paragraph 15 to 23
It has long been recognised among the Member countries of the Organisation for Economic Co-operation and Development that it is desirable to clarify, standardise and confirm the fiscal situation of taxpayers who are engaged in the commercial, industrial, financial or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation. This is the main purpose of the OECD Model Tax Convention on Income and on Capital, which provides a means of settling on a uniform basis the most common problems that arise in the field of international juridical double taxation. As recommended by the Council of the OECD, Member countries, when concluding or revising bilateral conventions, should conform to the Model Convention as interpreted by the Commentaries thereon and having regard to the reservations contained therein and their tax authorities should follow these Commentaries as modified from time to time and subject to their observations thereon, when applying and interpreting the provisions of their bilateral tax conventions that are based on the Model Convention.\(^1\)

The OECD Model Tax Convention comprises 31 Articles (Annexure 1) all of which are interpreted by the Commentaries. The Commentaries are prepared and now updated regularly by the OECD Committee on Fiscal Affairs and aim to provide clarity or guidance or narrow the field of interpretation with regards to the Articles themselves. The Model Tax Convention, and Commentaries, were static since the first Model Bilateral Convention was drawn up in 1928. However as from 1991 the Committee on Fiscal Affairs as a result of recognising the increasing complex nature of cross border transactions, economic and political developments and ever increasing sophisticated methods for tax avoidance and/or evasion adopted the concept of an ambulatory Model Convention providing for periodic and more timely updates and amendments without waiting for a complete revision.\(^2\)

In his Commentary on Double Tax Conventions at m.no 26 page 20 Klaus Vogel states: *(italics added)*

\[\text{“Tax Treaty Rules} \text{ assume that both contracting states tax according to their own law; unlike the rules of private international law, therefore treaty rules do not lead to the application of foreign law, } imposed \text{ on the residents of the Republic. Rather, treaty rules, to secure the avoidance of double taxation, } limit \text{ the content of the tax law of both contracting states: in other words, the legal consequences derived from them alter domestic law, either by excluding application of provisions of domestic tax law where otherwise it would apply, or by obliging one or both States to allow a credit against their domestic tax for taxes paid in the other state. Within the scope of a treaty, therefore, a tax obligation exists only if and to the extent that, in addition to the requirements of domestic law, the treaty requirements also are satisfied. Consequently, rules of double taxation are not conflict rules similar to those in private international law. Rather they are } \text{‘rules of limitation of law’ comparable to those of an ‘international administrative law’ as it has been described and analysed by Karl Neumeyer. Ordinarily, however, such rules of limitation are embodied in or closely related to, the substantive rules of the domestic law of the State in question. In contrast, the treaty rules have an independent origin and legal foundation”.*}

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1. Model Tax Convention on Income and on Capital – Commentaries Introduction paragraph 2 & 3
2. Philip Baker, OECD Introduction to the Convention, Historical Background.
The aims of a tax treaty do not confer any additional rights upon a taxpayer per se over and above those that may be afforded by the domestic laws of the Contracting States which give effect to the treaty. Therefore should a taxpayer feel aggrieved because a Contracting State appears not to adhere to the terms of an agreement there can be no legal action by the taxpayer against the offending State. It is submitted that the only recourse could be through diplomatic means by the taxpayers own government to rectify what may be an infringement of the agreement. The matter was aptly stated by Viscount Simmonds in the matter of Colico Dealings, Ltd. v. Inland Revenue Commissioners as follows:

"But it is said in the first place that it is not entitled under an enactment but under an agreement (which the appellant company, to add weight to the argument, prefers to call a treaty). This contention cannot be accepted. The appellant company has no rights under any agreement. Its rights arise under the Act of Parliament which confirms the agreement and gives it the force of law.

In its arguments for the appellant company Council sought to rely on the terms of the tax treaty between the UK and Eire, in the company’s attempts to recover tax charged on dividends paid by its UK subsidiaries, under s349 and Sch 18 part 1 of the UK Income Tax Act 1952. The section gives effect specifically to the Treaty with Ireland for the exemption of UK tax for residents of the Republic of Ireland who are not also residents of the UK. However in the recognition of the practice of dividend stripping by persons seeking to take advantage of the provisions relating to the exempting of tax on dividends (not only by residents of Eire) the UK legislature by s4(2) of the Finance (No 2) Act 1955 restricted such exemptions. The company however argued that the words of s4(2) could not be interpreted too widely as to include the residents of the Republic of Ireland and that if so would create a breach of the 1926 and following agreements and would be inconsistent with the comity of nations and the established rules of international law, the subsection must, accordingly, be so construed as to avoid this result. Upholding the absence of any rights of a taxpayer in relation to any Treaty, where any Act of Parliament is clear in its wording and presents no ambiguities the section must be followed according to its wording. Viscount Simmonds went further, it is considered with respect appropriately, to quote from a passage at p. 148 of Maxwell on Interpretation of Statutes (10th Edn.) as follows:

"But if the statute is unambiguous, its provisions must be followed, even if they are contrary to international law". It would not, I think, be possible to state in clearer language and with less ambiguity the determination of the legislature to put an end in all and every case to a practice which was a gross misuse of a concession. What, after all, is involved? It is nothing else than that, when Parliament said "under any enactment", it meant "any enactment except...

and then concluded,

"But it was not found easy to state precisely the terms of the exception. The best that I could get was "except an enactment which is part of a reciprocal arrangement with a sovereign foreign state".

Notwithstanding the legal interpretations, the following wider objectives have also been attributed to a Double Tax Treaty (International Tax: A South African Perspective [2003], Lynette Olivier, Objectives of DTA’s at 246)

- the facilitation of international trade and investment by the removal of procedural and substantive tax barriers,

- the allocation of expenditure and income between business activities conducted in the countries concerned, whether through means of branches, permanent establishments or otherwise

- the establishment of an arms length principle as the standard for the adjustment of transfer prices by tax authorities in the case of transactions between associated enterprises,

- the formulation of non-discrimination, mutual assistance and the exchange of information,

- the provision of non-discrimination provisions on the basis that non-residents are to be treated on the same basis as residents of a particular country are actually treated,

- the simplification and harmonisation of rules governing international taxation,

- the creation of procedures for dispute resolution,

- the curtailment of possible abuse of treaties, especially with reference to the insertion in the more recent treaties that exemptions pertaining to interest, royalties and dividends would apply only to the extent that the recipient in the other country is in fact the beneficial owner thereof,
TAXES COVERED BY THE TREATIES

The title of the OECD Model Tax Convention on Income and on Capital reads, “Convention….with respect to taxes on income and on capital”, which in itself may be self explanatory in so far as the agreements reached between contracting states are intended to cover taxes imposed on income and or capital.¹

Article 2 of the Model Treaty reads as follows:

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
3. The existing taxes to which the Convention shall apply are in particular:
   a) (in State A): ..........................................
   b) (in State B): ..........................................
4. The Convention shall apply also to any identical or substantially similar taxes that 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 taxation laws.

The scope of Article 2 must be applied in harmony with the domestic tax legislation of the contracting states. Notwithstanding that Article 2 refers to ‘the political subdivisions or local authorities’ of a contracting state, since it is only the Income Tax Act of the Republic which gives effect for the ‘Prevention of or relief from double taxation’² and having regard to the wording of Article 2 it is considered that only the taxes as imposed by the Income Tax Act may be affected by any double tax agreement.

Whilst the Article refers to “….taxes on the total amounts of wages or salaries paid by enterprises…” the phrase does not refer to any ancillary charges that may be levied by an enterprise based on the total amount paid in respect of wages or salaries e.g., Unemployment Insurance Contributions or the Skills Development Levy. The Commentary to Article 2 specifically refers to these ‘ancillary’ charges and at paragraph 3 states:

   “Social security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as “taxes on the total amount of wages”.

In its reservations Greece, holds the view that “taxes on the total amounts of wages or salaries paid by enterprises” should not be regarded as taxes on income and therefore will not be covered by the Convention.

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¹ In his book “Basic International Taxation” Roy Rohatgi refers at Pg 2 to “Diamond and Diamond, International Tax Treaties of all Nations, which lists over 20 different types of tax treaty. Besides comprehensive double tax avoidance agreements on income and on capital, the list includes treaties on inheritances, estates and gifts and treaties on administrative assistance in tax matters.
² Income Tax Act - Section 108
That the Article is intended to apply to taxes on income and capital would therefore not apply to Value Added Taxes or Sales Taxes that may be charged by a contracting state.

An indication as to the income and capital that may be covered by any agreement based on the Model Convention is provided by separate Articles of the Convention, Chapters III and IV (Annexure 1)
The scope of Article 2 extends to ‘political subdivisions and local authorities’ which the commentaries note is immaterial for the imposition of the taxes. It is understood that South Africa has reserved its position regarding ‘local authorities’; inferring that the Model Convention would not apply to any taxes imposed by any such local authority, however there appears to be no reference to ‘political subdivisions’ a term which is included in a number of South African agreements. This position is uncertain since section 228 of the Constitution² prohibits the levying of income taxes by the provinces.

Whilst paragraphs 1 and 2 of the Article are given extremely wide terms most of the agreements concluded by the Republic also incorporate paragraph 3 to include particular taxes applicable to either state. The following extracts from the agreements with Switzerland and the USA serve as examples of the contrast which may exist in agreements concluded by the Republic concerning the taxes covered:

CONVENTION BETWEEN THE REPUBLIC OF SOUTH AFRICA AND THE SWISS CONFEDERATION.....

Article 2
Taxes covered

1. This Convention shall apply to taxes on income imposed on behalf of each Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income all ordinary and extraordinary taxes imposed on total income or on elements of income, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are, in particular:

   (a) in the case of South Africa:
      (1) the normal tax;
      (2) the non-resident shareholders' tax;
      (3) the undistributed profits tax;
      (4) the provincial income tax; and
      (5) the provincial personal taxes
      (hereinafter referred to as 'South African Tax');

   (b) in the case of Switzerland:
      the federal, cantonal and communal taxes on income (total income, earned income, income from capital, industrial and commercial profits, capital gains, etc.)
      (hereinafter referred to as 'Swiss Tax').

4. The Convention shall also apply to any identical or substantially similar taxes which are subsequently imposed in addition to, or in place of, the existing taxes. At the end of each year, the competent authorities of the Contracting States shall notify to each other any changes which have been made in their respective taxation laws.

5. The Convention shall not apply to Federal anticipatory tax withheld at the source on prizes in a lottery.

¹ Phillip Baker, A Manual on the OECD Model Convention on Income and on Capital
The convention with Switzerland was concluded and signed at Pretoria during August 1967 which could explain the reference to ‘provincial taxes’ since paragraph 228 of the Constitution\(^1\) specifically excludes any of the provinces from the charging of income taxes.

An unsettling contrast between these two examples lies in the extent to which the agreements differ in so far as the Swiss agreement includes provincial (Cantonal) taxes whilst the agreement with the USA is restricted to Federal Taxes only and therefore would not include any State income taxes. Thus whenever any transactions are undertaken with a US enterprise or for that matter any South African resident seeking to earn any income or a realisation of a capital gain in the United States should seriously take cognisance of the potential for the imposition of taxation by both the Republic and the particular State in which the income or capital gain may be earned.

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MODEL TAX CONVENTIONS AND THAT FOLLOWED BY SOUTH AFRICA

Whilst there are three universally accepted Double Tax Conventions, the OECD, UN and the USA model tax treaties it is the OECD model which South Africa has largely followed for its international double tax agreements. The impact of this Model Tax Convention on Income and on Capital developed by the OECD Committee of Fiscal Affairs has extended far beyond the OECD area. It has been used as a basic document of reference in negotiations between Member and non-Member countries and even amongst non-Member countries, as well as in the work of other worldwide or regional international organizations in the field of double taxation and related problems. Most notably, it has been used as the basis for the original drafting and the subsequent revision of the United Nations Model Double Taxation Convention between Developed and Developing Countries, which reproduces a significant part of the provisions and Commentaries of the OECD Model Convention. It is in recognition of this growing influence of the model convention in non-member countries that it was agreed, in 1997, to add to the model convention the positions of a number of these countries on its provisions and Commentaries.¹

Tax Sparring

The UN model whilst based to a large extent on the OECD model is amended to cater for the needs of developing countries. Whilst a detailed comparable study of the differences between the OECD and UN model treaty is beyond the scope of this paper it is considered that a significant differential between the two is attributed to the latter’s wider recognition of ‘tax sparring’. This term refers to the acceptance by the Resident State of a notional tax credit, as provided by the Source State, against the tax charged on the investors income in the Resident State. The social and economic development needs of a developing (Source) State may induce such States to offer incentives for foreign investment. Such incentives may include reduced rates of tax or no charge to tax at all. If however the foreign investor is subject to tax in his own State at full rates on worldwide income then such tax benefits by the source State may negate any such incentive to investment in the developing State. To the extent of its recognition for investment in the Source State the Double Tax Agreement may provide that notional taxes, that is taxes that would otherwise be payable except for the investment incentive, will be allowed as a full credit against taxes imposed in the Resident State. The South African Double Tax Agreements that provide for tax sparring provisions include Algeria, Egypt, Mauritius, Pakistan, Romania, Israel, Thailand and Tunisia. It appears that there are no such provisions that have been included with any of the agreements concluded between any African State.

Double Tax Treaties are international agreements, rules, established between two Contracting States where mutual agreement is reached with regards to the manner of taxation of income and capital gains for the purpose of the avoidance of juridical double taxation and which agreement may also provide for reciprocal assistance in the collection of taxes due to one of the party states together with the exchange of information that facilitates the administration and enforcement of taxation in accordance with the domestic tax laws of either state. Such agreements do not add to or subtract from the domestic taxing laws of a State but rather are designed to prevent one or other Contracting States from exacting tax or to require it to give a credit for the tax imposed by the other state.

Thus where State A, which taxation system is sourced based, seeks to tax an enterprise on its business profits arising within its jurisdiction although the enterprise is resident in State B, and in the absence of any permanent establishment in State A, then a Double Tax Agreement would normally provide for the taxing jurisdiction where residence is established to prevail, in this example State B. Should the enterprise however be found to have a permanent establishment in State A then generally a Double Tax Agreement, based on the OECD model, would normally provide for the business profits to be taxable in State A. In terms of Article 7 para 1 of the OECD model tax convention:

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.
THE STATUS OF A TAX TREATY UNDER SOUTH AFRICAN TAX LAW.

The general provisions, chapter 14, of the Constitution by sections 231 to 233 allow for the incorporation into South African law of all International Agreements and Customary International Law, (Annexure 2). Whilst not making or decreeing law itself with regards to the taxing rights of the State the Constitution gives authority to the National Executive with regards to International Agreements,

By recognising the negative impact of double taxation on international trade and its impediment to economic growth for the Republic s108 of the Act\(^1\) allows the National Executive to enter into any agreement with the government of any other country for the objective of the prevention or relief from tax imposed by another state on the same income which may be subject to tax in the Republic, juridical double taxation. The section reads as follows:

108 Prevention of or relief from, double taxation

(1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.

(2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act.

(3) and (4) Deleted.

(5) The duty imposed by any law to preserve secrecy with regard to such tax shall not prevent the disclosure to any authorised officer of the country contemplated in subsection (1), of the facts, knowledge of which is necessary to enable it to be determined whether immunity, exemption or relief ought to be given or which it is necessary to disclose in order to render or receive assistance in accordance with the arrangements notified in terms of subsection (2).

When would a Double Tax Agreement become effected into law of the Republic may be answered by s108(2) which refers to “…..as contemplated in section 231 of the Constitution…”. The section then appears to give effect to the due legal process by stating “…..the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act”. Whilst the provisions of s108 allow for the National Executive to enter into a double tax agreement the legal process in itself is an interaction with the Constitution. We must therefore look at the provisions of s231 in order to determine the necessary requirements for the incorporation or enactment of any International Double Tax Agreement into the Taxing Laws of the Republic. (Annexure 2).

Both s108(1) and s231(1) give the National Executive the authority and responsibility to enter into any International Agreement on behalf of the Republic. In order to bind the Republic to such agreements however the Constitution requires the Agreement to be approved by resolution of both the National

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\(^1\) Income Tax Act 58 of 1962 s108
Assembly and the National Council of Provinces s231(2). However in terms of s231(3) if such agreement is of a technical, administration or executive nature or an agreement which does not require either ratification or accession, which has been entered into by the National Executive still binds the Republic without approval by the National Assembly and the National Council of Provinces, although the Agreement must still be tabled in the Assembly and the Council within a reasonable time. The reference to ‘technical, administrative or executive nature’ has not been defined or given any further interpretation, nor has there been any further elaboration as to the circumstances where any Agreement would not require either ratification or accession.¹

The Constitution by s231(4) gives force to s108(2) by its reference to “Any International Agreement becomes law in the Republic when it is enacted into law by national legislation….”. It is therefore considered that the legislature when enacting s108(2) intended that the force of a Double Tax Agreement would only have effect in law on the outcome of a two stage process, namely that:

1. approval of Parliament was a pre requisite which would therefore require there to be an approval process as provided for in terms of the Constitution,

2. such arrangements as have been approved by the National Executive for the conclusion of a Double Tax Agreement must be published in the Gazette whereupon such arrangements shall have effect as if enacted in the Income Tax Act.

However the absence of any definition, elaboration or interpretation as to the terms ‘technical, administrative or executive nature’ may, it is proposed, lead to conjecture any assertion that approval in terms of s231(2) is a mandatory requirement in order to fully satisfy the conditions that would give effect to a Double Tax Agreement, “…as if enacted in this Act”, s108(2).²

The reference to ‘National Executive’ by s108(1) arises from an amendment by s38(1)(a) act 28 of 1997 replacing the term ‘State President’. In terms of the explanatory memorandum the amendment proposed in terms of the clause is to bring the provisions of s108 of the principle act in line with the Constitution. Whilst the term ‘National Executive’ is not defined by the Constitution it is considered that the State President would be the authority for which any international agreement is concluded, this premise is based on the provisions of Chapter 5 of the Constitution regarding The President and the National Executive.

¹ Further Reading: Prof NJ Botha, Treaty Making in South Africa: A reassessment, South African Year Book of International Law (2000) at Pg 73 ‘Negotiation and signature of international agreements’ and at Pg75 ‘Agreements requiring executive approval only’

² ibid
Whilst it may be observed that s108 makes no provision for any instance where a conflict may arise between a Double Tax Agreement and the provisions of the Income Tax Act, the provisions of s232 and s233 of the Constitution have relevance for the resolution of such conflict on the basis of the DTA having force in terms of International Law. As also stated by s108(2) arrangements made in terms of a DTA shall in terms of s108(2) ‘have effect as if enacted in this Act’.

Therefore when considering the nature of any conflict we may be drawn to the possibility of abuses of a DTA that result in, the unacceptable, avoidance or postponing of taxes imposed in the Republic. Since the DTA in terms of s108(2) shall have effect as if enacted in the Act then it must follow that any actions regarded as an abuse of a Double Tax Agreement could result in such action falling foul under the provisions of s103.

The potential for abuses of a DTA is also recognised by the Committee on Fiscal Affairs (CFA) which considers any abuse to fly against the spirit of the DTA. The commentaries to Article 1 at para 7.1 state that “It is also the purpose of tax conventions to prevent tax avoidance and evasion” and therefore it is agreed that the States which are party to the agreement do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.¹

There is no definition in the Constitution of the term ‘international agreement’ as also there is no definition in the Income Tax Act to the term ‘agreement’ as contained by s231 and s108 respectively. It is considered however these terms ought not to be given any special technical meaning but should rather be understood as a generic term encompassing all forms of treaties. This would thus include bi- and multilateral treaties, conventions, protocols, exchanges of notes and the like.² Some clarity may however be taken from the Judgement in Harksen v President of the Republic of South Africa and Others 2000 (5) BCLR 478 (CC) where at para 21 Goldstone J stated:

‘Although the judicial determination of the existence of an international agreement may require the consideration of a number of complex issues, the decisive factor is said to be whether “the instrument is intended to create international legal rights and obligations between the parties.”’

¹ OECD Model Convention Commentaries Article 1 para 9.4
² See, International Tax A South African Perspective, Lynette Olivier at Pg 252/253
Consideration may also be given to the definition of the term “Treaty” by article 2(1)(a) of the Vienna Convention as:

“an international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”

The remarks of Goldstone J in the Harksen case at para 26 are however also noteworthy with regards to the status of the Vienna convention:

‘Although the extent to which the Vienna Convention reflects customary international law is by no means settled….”

Other than the formulating of agreements which have as a primary objective the aim of preventing juridical double taxation, s108(1) also provides “….or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country”. Whilst similar provisions to those of s108(1) are contained by Articles 26 and 27 of the Model Convention however is it considered that the extent to which a State may intervene in the collection of taxes owing to another state from persons in the host state may be administratively impractical or if so would be a matter for judicial decision by the host State.¹

It should be noted however that para 1 of Article 27 of the model DTA, is of particular significance in so far as assistance (in the collection of taxes) is not:

a restricted by the provisions of Articles 1 which in effect may extend the powers of the collecting state to non residents of that State,

b restricted by Article 2 to taxes on income and or capital but it is submitted can apply to any revenue claim of the other contracting state,

Few of the agreements in force, e.g. those with Algeria, Belgium, Denmark, India, Lesotho, Namibia, Norway, Uganda, contained any reference to the mutual assistance in the collection of taxes in accordance with Article 27.

¹ The commentaries to Article 27 of the Model DTC state at para 1 that in some countries, national law, policy or administrative considerations may not allow or justify the type of assistance envisaged under this Article or may require that this type of assistance be restricted, e.g. to countries that have similar tax systems or tax administrations or as to the taxes covered. For that reason, the Article should only be included in the Convention where each State concludes that, based on the factors described in paragraph 1 of the Commentary on the Article, they can agree to provide assistance in the collection of taxes levied by the other State.
Exchange of Information – s108(1) and Article 26 of the Model Convention

Almost all of the double tax agreements in force contain provisions in accordance with Article 26, ‘Exchange of Information’. The Article is applied by the provisions of s108(1) ‘…rendering of reciprocal assistance…’ that in turn is supported by the provisions of s108(5) relating to the preservation of secrecy. The provisions of s108(5) it would appear thus override those of s4 regarding the preservation of secrecy of information at the disposal of the Commissioner

In order that the provisions of the article may be applied by either state the information requested can only be necessary if it is **relevant in law to taxation** by the contracting State requesting it, that is relevant to the carrying out of the provisions of the DTC or **to the extent that a major information clause** has been agreed upon relevant to the carrying out the provisions of its domestic law and if that contracting State is unable to procure such information by means of inquiries of its own within its own territory. All domestic sources of information must therefore have been exhausted before a request for information may be made. If one of the two conditions cannot be met there is no obligation under the treaty to furnish information

(Vogel Klaus Vogel on Double Taxation Conventions (third edition 1999) 1406 m.no 31)

Limitations are contained in paragraph 2 of the Article in respect of the information that may be requested and which are aimed at preventing undue disclosure contrary to the domestic laws of the requested state or placing an undue burden on its administrative capacity or of information which may lead to the disclosure of industry sensitive information, the paragraph reads:

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).

The Commentaries to Article 26 lay emphasis on the secrecy of information exchanged, para 11 reads:

Reciprocal assistance between tax administrations is feasible only if each administration is assured that the other administration will treat with proper confidence the information which it will receive in the course of their co-operation. At the same time maintenance of such secrecy in the receiving Contracting State is a matter of domestic laws. It is therefore provided in paragraph 1 that information communicated under the provisions of the Convention shall be treated as secret in the receiving State in the same manner as information obtained under the domestic laws of that State. Sanctions for the violation of such secrecy in that State will be governed by the administrative and penal laws of that State.
The change in the South African tax system to that of a residence based system gives rise for many areas where the need for information by the South African Revenue Service (SARS) is crucial to a proper examination and assessment in accordance with the domestic tax laws. Such exchange of information may be required as follows:

Application of the Convention

Royalties (Article 12) – where a non-resident receives income in the form of Royalties from a resident of the Republic the SARS may receive a request from the other contracting state for confirmation of the amounts paid by the South African Resident. Conversely the SARS may request information of the other Contracting State with regards to the claimed beneficial ownership of the Royalties that may otherwise be taxable in terms of s9(1).

Permanent Establishment (Article 5) – in order to determine the extent to which a permanent establishment exists in the other contracting State the SARS may require information regarding a Controlled Foreign Company for the purposes of s9D, that is on the understanding that all existing means for the determination of the information required has been exhausted.

Implementation of South African Tax Laws

Transfer pricing – International Transaction - s31 – the SARS may need to establish the prices paid by a foreign company for the purpose of determining the ‘arms length’ price in the determination of the taxpayers taxable income

Disposal of assets 8th Schedule, where an asset has been disposed of by a resident that was acquired from a non resident, the SARS may request information regarding the amounts declared by the non resident in his tax returns to the other State.
THE OECD COMMENTARIES AND TAX TREATY INTERPRETATION. AND THEIR RELEVANCE TO DOMESTIC TAX LAWS

It is considered that any bilateral agreement cannot *per se* endeavour, in its construction, to take into consideration every conceivable interpretation of its contents, particularly the interpretations of those who may not have been a party to its conclusion. In this respect therefore as stated by Vogel\(^1\), “international agreements, like domestic law, require interpretation”. This may be even more so for agreements that are based on the OECD Model Tax Convention, without added detail, which itself is seen to be drafted in terms far wider than that of even South African domestic tax law. The references to ‘Business Profits’ and “Permanent Establishment” by Articles 7 and 5 respectively of the Model Convention may serve as examples. In the former instance there is no concept or definition of ‘Business’ or of ‘Profit’ in the Income Tax Act whilst the definition of ‘Permanent Residence’ by s1 reads:

\[
\text{‘permanent establishment’ means a permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development;}
\]

Whilst any international agreement shall be regarded as having effect as if enacted in the Act\(^2\) it is considered that any attempt at interpretation, of its provisions, along lines as may be used for domestic tax law could be fraught with unclear, inappropriate or misleading conclusions and or decisions.

In view of their lack of precision and to facilitate their interpretation each of the 31 Articles of the OECD Model Tax Convention (*Annexure 1*) are interpreted by the Commentaries. The Commentaries are prepared and now updated regularly by the OECD Committee on Fiscal Affairs and aim to provide clarity or guidance or narrow the field of interpretation with regards to the Articles themselves. The Model Tax Convention, and Commentaries, were static since the first Model Bilateral Convention was drawn up in 1928. However as from 1991 the Committee on Fiscal Affairs as a result of recognising the increasing complex nature of cross border transactions, economic and political developments and ever increasing sophisticated methods for tax avoidance and/or evasion adopted the concept of an ambulatory Model Convention providing for periodic and more timely updates and amendments without waiting for a complete revision\(^3\).

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1 Klaus Vogel – Interpretation of Double Tax Treaties, Introduction m.no 59  
2 Income Tax Act 58 of 1962 s108(2)  
3 Philip Baker, OECD Introduction to the Convention, Historical Background.
The Introduction in the Commentaries is considered to be a useful reference in their description of the legality, aims, purpose, uses and objectives not only of the Commentaries themselves but also of the Model Tax Convention, (refer Annexure 3 for selected paragraphs with regards to General Remarks on the Model Convention): ¹

The commentaries are generally structured in a consistent manner by:

a. providing an interpretation and in some instances an historical background to the development of the Article,

b. observations by member states to the Article, and/or,

c. reservations by members states to particular Articles, which may restrict an Articles application in any agreement that has been concluded by that State based on the OECD Model Convention

It is considered that the extent of judgements by South African courts, particularly at the Appellant Division level, having a reference to the Commentaries is still very limited. This limited exposure is probably understandable in view of:

a. the relatively short period of time the Republic has been exposed to open and unencumbered international trade,

b. the recent adoption of the residence based tax system,²

³ The Downing Case: Secretary For Inland Revenue v Downing 1975 (4) SA 518 (A) 37 SATC 249 is regarded as the main authority in South African Income Tax Law with regards to the application of the OECD Commentaries

The case is of particular interest in so far as the decisions of both the lower court and the Appellant Division have a significant bearing on the interpretation of Double Tax Agreements in the application of South African Income Tax Law. The case was first heard on appeal in the Natal Income Tax Special Court (unreported), Case No 6737 August 1972 where the matters to be decided were broadly that:

a. gains from the sale of shares were amounts of a capital nature and did not fall within the definition of “gross income”, inasmuch as the gains resulting from the sale of shares were incidentally obtained in the process of changing investments from time to time,

¹ OECD Commentaries: Introduction, para 28 to 30
² Effective as from years of Assessment commencing from January 1 2001
b. even if such profits were properly to be regarded as income, in terms of the Convention between the Republic of South Africa and the Swiss Federation (for the avoidance of double taxation with respect to taxes on income) and more particularly in terms of articles 7 and 13 thereof, such profits could not be assessed to tax in the Republic.

The facts of the case are, briefly, as follows:

The Secretary for Inland Revenue sought to include in the taxpayers income for the years of assessment 1966, 1967, and 1968 profits made from the sale of shares in a managed portfolio. The profits for each of the above years were R42,999, R21,582 and R31,458 respectively. Since the taxpayer had resided in Switzerland, emigrating from South Africa during 1961, the contention was, other than the 'Income vs Capital' aspect of the transactions, that by virtue of his Swiss residence status he could not be taxable in the Republic in terms of the Double Taxation Agreement in force between the Republic and Switzerland.

The Special Court held firstly that the amounts in issue were not receipts of a capital nature but constituted income earned in the carrying out of a scheme for profit-making; but that, in terms of the convention, respondent was exempt from tax in the Republic of South Africa in respect of these amounts.

It is in respect of the latter part of the judgement which is of particular interest for the application of a Double Tax Agreement in the taxing of profits that would ordinarily be taxable in the Republic. In his main submissions for the Secretary, Council argued that since the profits from the share dealings would not in any event be taxable in Switzerland, by virtue of such profits being regarded as of a Capital nature, the Convention has no application and that therefore in the absence of any effect of the Double Tax Agreement the taxpayers profits are therefore taxable in the Republic in terms of the Income Tax Act, as if the Convention did not exist at all.

In delivering his judgement Miller J states:

‘To quote from a communication addressed by the Federal Tax Authority to the appellants attorneys in Geneva;

“Profits realised on the sale of South African shares are considered as capital gains and, consequently, are not taxable as income either for the Canton or for the National Defense Tax. For private individuals, the sale of shares does not constitute a taxable income”
The argument proceeds that on a proper interpretation of the Double Tax Convention, which was entered into for the purpose of avoiding double taxation, its provisions would become applicable only if and when “there was indeed double taxation on a particular taxpayer by reason of the application of each States internal law”. That was the purpose and intention of the legislature when enacting section 108 of the Income Tax Act. Reference was further made by Council for the Secretary to a 1963 report of the Fiscal Committee of the Organisation for European Economic Co-Operation and Development which stated at page 9 para 3:

‘…..double taxation may be generally defined as the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods”

In his response to Council’s arguments Miller J stated:

I have no doubt that the hardship or inequity which international taxation conventions were designed to avoid or ameliorate was that of actual double taxation. And it is clear that the draft convention contained in the OECD report was designed to serve as a model for the attainment of that end. But it does not follow that because actual double taxation was the malady sought to be prevented, contracting States, necessarily stipulate in their own convention that their arrangement or agreement was to be of application only where an instance of double taxation actually arose. In section 108(1) of our Income Tax Act, the State President is empowered to enter into an agreement with any other country with a view to the prevention of double taxation. It appears to me to be implicit in a purpose to enter into an agreement to avoid, or to prevent, double taxation, that such agreement need not be confined to therapeutic measures but may include prophylactic measures as well

The above statement is interpreted to mean that (double tax) agreements are not brought about for the purpose of remedial action for a given event but to guard against the inappropriate imposition of a tax no matter what the position may be as regards the internal laws in either contracting State.

Adopting the normal rules of interpretation of any international agreement Miller J further stated:

I do not think that any special approach, deviating materially from the norm, is necessary, to the interpretation of a convention such as we are concerned with. In certain treaties between independent states it may be necessity to have regard to reasonableness and uniformity when determining the meaning of the words used, but the important point is still “to get at the real intention” which is primarily to be ascertained from the words used.

The correctness of the Special Tax Court ruling having regard to the Double Tax Convention was the primary issue on the appeal to the appellant division. It appears however that the case stated in this appeal was not based on the main arguments of Council for the Secretary as heard by the Natal Income Tax Special Court. The appeal was based on the notion that the taxpayer had conducted business in the Republic of share dealings through a permanent establishment based in the Republic.
At the time of the appeal there was no definition of ‘permanent establishment’ in the Income Tax Act, this only being inserted by s5(g) of Act No 5 of 2001. The Court therefore referred to the definition from Article 5 of the actual Double Tax Agreement;\footnote{The insertion by s5(g) reads as follows: ‘permanent establishment’ means a permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development;}

Permanent establishment

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

The Judgement then went on to interpret the meaning of “permanent establishment” as given by Article 5 para 4 & 5 of the agreement and its applicability to the facts of the present case. In delivering his Judgement Corbett J stated;

> It really amounts to deciding whether the facts found as to the normal scope of a stockbroker's business bring the case within the provisions of para. 5 and, more particularly, within the ambit of the words "broker, general commission agent or any other agent of an independent status... acting in the ordinary course of his business";

It is considered the dismissal of the appeal by the Appellate Division, with respect, was the appropriate decision for the reason that the carrying on of a business through a permanent establishment, as defined by Article 5 of the Convention, must entail a degree of effective management of the resources at hand. The delegation of those activities that are required in order to produce a result is not the carrying on of a business merely by the use of an independent service provider who acts on his own initiative without supervision. It is also considered that in the interpretation, of conducting a business through a permanent establishment, regard cannot be had to any guidelines that an independent service provider may be required to follow for the purpose of the investment policies of the owner of the resources at hand.

*The Transvaal Hide and Skin Case 29 SATC 97* - Whilst the South African courts take cognisance of decided cases of neighbouring states it is unfortunate that the court in this case preferred an alternative interpretation of the agreement in force at the time between the Government of Great Britain and Northern Ireland and the Government of the Union of South Africa. Whilst the double tax agreement provided for an apportionment of income in circumstances where profits could be attributed to both South Africa and Botswana (*formerly Bechuanaland*) the court nevertheless took the view that such an apportionment would not be in conformity with the Income Tax Proclamation of Botswana at the time.

\footnote{See also Article 5 para 1 of the Model Tax Convention upon which the Swiss DTT was based}
Briefly the facts of the case are as follows:¹

The taxpayer, a company registered in South Africa and having its head office in Johannesburg, carried on business as a dealer in hides and skins. It purchased hides from an abattoir in Lobatsi, Botswana, where they were washed and cured by salting. After the curing process was completed the hides were transported to South Africa where they were sold.

The Collector of Income Tax, Botswana, assessed the taxpayer on its profits derived from the sale of hides purchased in Botswana and the taxpayer appealed to the High Court of Botswana, which held that the source of such profits was Botswana. The case then went on Appeal to the Botswana Court of Appeal.

In terms of section 68(2) of the Income Tax Proclamation, agreements such as those made in the Double Tax Agreement ‘shall, so far as they relate to immunity, exemption, or relief in respect of the Bechuanaland Protectorate Income Tax, have effect as if enacted in the Proclamation, but only if and for so long as such arrangements, so far as they relate to immunity, exemption or relief in respect of Income Tax levied or leviable in the other country have the effect of law in that country’.

The appellant relied on Paragraph (1) of Article III of the agreement for relief from tax which reads:

“The industrial or commercial profits of an enterprise of one of the Governments shall not be subject to tax in the territory of the other Government unless the enterprise is engaged in trade or business in the other territory through a permanent establishment in that other territory. If it is so engaged tax may be imposed on those profits by the other territory but only on so much of them as is attributable to that permanent establishment.”

Whilst the facts of the case could clearly show the appellant had conducted its business through a permanent establishment in Botswana nevertheless the court did not apply the solution of apportionment as provided by the agreement.

In his decision Maisels JA expressed the view on the provisions of the agreement as follows;

“Mr Gould contended that as the Double Tax Agreement is still in force, the Income Tax Proclamation must be taken to be amended pro tanto, ie to the extent to which it is necessary to give effect to the Agreement. I shall assume this to be so, although I am in some doubt whether agreements of this nature should not be considered merely as inter-government arrangements which afford the resident of a state relief as against his own state in cases where he is taxed in the other state and in his own state, and not as affording the non resident exemption from taxes for which he would be liable in terms of the taxation laws of the state of which he is a non-resident”

With respect it is considered the court ought to have viewed the agreement in force with more reverence than was afforded and though cases decided by the Court of Appeal in Botswana may have some persuasive influence on South African courts it is suggested that the approach to treaty interpretation adopted by this case should not be followed (Horak JDD, The Use and Abuse of Double Tax Agreements LLM Univ Of Stellenbosch (1987))

¹ Facts as taken from Income Tax Cases & Material - TE Emslie
FCT v Lamesa Holdings BV (1997) 77 FCR 597

This Australian case examines the provisions of the Netherlands-Australia tax treaty to determine the extent to which the respondent, a company registered in the Netherlands, is liable to pay Australian income tax in respect of profits made by it from the sale of shares in an Australian publicly listed company, Australian Resources Limited (ARL). The sales of the shares by Lamesa it is accepted formed part of its assessable income under s 25(1)(b) of the Income Tax Assessment Act 1936 (Cth) (as amended) (the Tax Act) as being income in the ordinary course of events as derived from a source in Australia. An earlier assessment had been made based upon the view that the profits were within the capital gains tax provisions of the Tax Act and so therefore assessable through s 160ZO(1) of the Tax Act, but on objection the Commissioner had formed the view that the gains were of an income and not of a capital nature. In its objections to the assessment the Respondent relied upon the provisions of the Netherlands-Australia Double Taxation Agreement 1976 (the Agreement) as incorporated into Australian municipal law by force of s 4 of the International Tax Agreements Act 1953 (Cth) (the Agreements Act) and Sch 10 and 10A of that Act. It is common ground that the Agreements Act has effect notwithstanding anything inconsistent with its provisions in the Tax Act, save as to the provisions of Part IV A of the Tax Act (the anti-avoidance provisions) which are not relied upon by the Commissioner in this case.

The Respondent was the holding company within a four-tier group structure (each subsidiary holding 100% of its immediate subsidiary) with the ultimate subsidiary company being the owner of Gold Mining Leases in Australia. The Commissioners argued that the profits on the sale of the shares did not fall within the ambit of Article 7 of the agreement, (similar to Article 7 of the Model Tax Convention), there being no permanent establishment in Australia through which the enterprise carried on business, in which event it was agreed the profit would be taxable in the Netherlands.

Ref also 36 ATR 589; 157 ALR 291; 97 ATC 4,752; 1997 WL 1882599 General Division: New South Wales District Registry
The profits, it was argued, fell within the provisions of Article 13 and therefore were taxable as such in Australia and not the Netherlands. The provisions of Article 13, as relates to the substantive submissions, of the Commissioner, provides as follows:

(1) Income from the alienation of real property may be taxed in the State in which that property is situated.

(2) For the purposes of this Article -

(a) the term ‘real property’ shall include -
   (i) ……
   (ii) ……
   (iii) shares or comparable interests in a company, the assets of which consist wholly or
         principally of direct interests in or over land in one of the States or of rights to
         exploit, or to explore for, natural resources in one of the States.

(b) real property shall be deemed to be situated -
   (i) ……
   (ii) ……
   (iii) where it consists of shares or comparable interests in a company, the assets of
         which consist wholly or principally of direct interests in or over land in one of the
         States, or of rights to exploit, or to explore for, natural resources in one of the
         States - in the State in which the assets or the principal assets of the company are
         situated.

(3) Gains…..

Whilst the Commissioner submitted four broad arguments for the taxing of the profits under Article 13 the Court found the argument of most substance was that the court should pierce the corporate veil and regard the assets of the subsidiary companies as being the assets of their parent and therefore “Provided overall within the group the assets of the group consist principally of direct interests in or over land etc, the provisions of Art 13(2)(a)(iii) will, it is submitted, have operation”.

The court was therefore required to decide the extent to which the terms of Article 13(2)(a)(iii) should be interpreted to refer to the assets of a subsidiary company in the determination as to the direct interest of the holding company in the those assets of that subsidiary. If the decision was in the affirmative then the profits from the sale of the shares would fall within the provisions of Article 13 by virtue of the shares in the subsidiary being ‘property’, that is the Gold Mining Leases, being assets “….which consist wholly or principally of… rights to exploit or explore for… natural resources in one of the States…” Article 13(2)(b)(iii).
In applying the principles of interpretation of double tax conventions the Australian courts generally adopt an approach based on Articles 31 and 32 of the Vienna Convention.\footnote{Thiel v FCT (1990) 90 ATC 4,717} In the present case the court referred to a previously decided case in the same court, albeit related to the International Convention on Refugees\footnote{Applicant A v Minister for Immigration and Ethnic Affairs (1977) 71 ALJR 381}, where it was stated:

‘The need to give the text primacy in interpretation is accentuated by the tendency of multilateral instruments to be the result of various compromises by various States or groups of States. If the subjective intentions of their representatives were the criterion, the interpretation of many international instruments might be impossible.’

Third, the mandatory requirement that courts look to the context, object and purpose of treaty provisions as well as the text is consistent with the general principle that international instruments should be interpreted in a more liberal manner than would be adopted if the court was required to construe exclusively domestic legislation.

Fourth, international treaties often fail to exhibit the precision of domestic legislation. This is the sometimes necessary price paid for multinational political comity. [See Bennion, Statutory Interpretation (2nd ed, 1992), p 461.] The lack of precision in treaties confirms the need to adopt interpretative principles, like those pronounced by Zekia J, which are founded on the view that treaties ‘cannot be expected to be applied with taut logical precision’. [Buchanan at 154.]

Accordingly, in my opinion, Art 31 of the Vienna Convention requires the courts of this country when faced with a question of treaty interpretation to examine both the ‘ordinary meaning’ and the ‘context ... object and purpose’ of a treaty.”

In finding against the Appellant the court held the following views:

1. that the drafters of the agreement between the Netherlands and Australia had intended that should any shares or comparable interest in a subsidiary be regarded as an interest in the assets of the subsidiary this assertion must be applied in limited circumstances, and that if so the agreement would have made specific provision for this,

2. The complexities of dealing with shares of a multi tiered structure particularly where such share holding were not wholly owned but of a lesser percentage interest, was conceivably eschewed by the parties to the Agreement,

3. In maintaining a consistency of rational policy the drafters of the agreement could in any event only have intended to assimilate the realty of only one tier of companies rather than numerous tiers,
4. Separate legal personality is a doctrine running not only through the common law but the civil law as well. No suggestion is made to the contrary. That is consistent with the plain and quite unambiguous language which the Agreement has employed. When legislation speaks of the assets of one company it invariably does not intend to include within the meaning of that expression assets belonging to another company, whether or not held in the same ownership group.

5. The language of the Agreement should be given effect. This is not to adopt a narrow or "illiberal" view of the Agreement. It is merely to interpret the language of the Agreement in the light of the broad purposes of juridical allocation which the Agreement embodies.

**TREATY OVERRIDE OR IN CONFLICT WITH DOMESTIC TAX LAWS.**

*Extent to which a Treaty may override domestic tax laws*

In terms of s233 of the Constitution when interpreting any legislation every court must prefer any reasonable interpretation of the legislation that is consistent with international law, *(of which tax treaties are a part)*, over any alternative interpretation that is inconsistent with international law. Whilst it may be stated, generally, that the purpose of double tax agreements are to resolve conflict, determine the taxing rights and set maximum levels of tax in situations where double tax is permitted there may be the inevitable situation where an interpretation is required having the effect of an override of the domestic tax laws. This effect may occur notwithstanding the widely held principle that any interpretation of double tax agreements must be undertaken in such a manner as to reconcile the agreement terms with those of domestic tax laws.

The interpretation of a DTA, read in conjunction with the Commentaries was addressed in the Special Tax Court in *ITC 1503*² *(1990) 53 SATC 342*. Whilst the court held that the DTA must be interpreted in accordance with the normal rules pertaining to the interpretation of contracts in the Republic, the issue as to whether interest earned on a South African bank account was taxable or not was decided in favour of the taxpayer.

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¹ Huxham and Haupt Notes on South African Income Tax (2004) paragraph 16.7.1
² Whilst the identity of the overseas country is not disclosed, from the facts of the case it is submitted the case involves the Republic of Portugal since there have only been three DTT’s in force (Brazil, Portugal and Spain) relating to the Business of Sea or Air Transport only and the references in the case to sections of the DTT resemble those of the SA/Portugal Agreement
The facts, briefly, are as follows:

The taxpayer carried on business as an international airline with a branch in South Africa. The taxation of its income derived in South Africa from its business of air transport was exempt from tax in terms of a double taxation agreement.

The taxpayer’s policy was to remit overseas the monies collected from the sale of tickets and cargo space which it considered surplus to its immediate needs, but interest was earned on current account in the interim period between collection and remittance. The taxpayer claimed that such interest was exempt from tax as being derived from the business of air transport. The Commissioner disputed this claim and assessed the interest to tax.

HELD, upholding the appeal, that in the circumstances of the case the interest fell within the scope of the exemption provided in the double taxation agreement.

The taxpayer had argued that based on the terms of a double tax agreement in force and in particular the terms of Article 2 of the agreement all income earned by the branch was connected with the business of air transport and therefore was exempt from income tax in the Republic, Article 2 of the Double Tax Agreement concluded by the taxpayer states;

(1) The Government of the Union of South Africa shall exempt all income derived from the business of sea or air transport between the Union of South Africa and other countries by C enterprises engaged in such business from income tax and all other taxes on income and profits which are chargeable in the Union of South Africa.'

It is accepted that any amount of interest earned by a resident falls within the definition of Gross Income\(^1\) whilst interest earned by non-residents would be subject to tax only if from a source within the republic. \(\text{ITC1503}\) is a case prior to the change in the basis of taxation to a residence basis with effect from years of assessment commencing January 1 2001. The previous definition of Gross Income would still ordinarily have been applicable to the case since the interest was from a source within the Republic. Prior to the 2000 amendment the definition of Gross Income read as follows:

\[
\text{'gross income', in relation to any year or period of assessment, means, in the case of any person, the total amount, in cash or otherwise, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within the Republic, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder. (emphasis added)}
\]

\(\text{\footnotesize{1 Section 1 Definition, Gross Income, as amended by the Revenue Laws Amendment Act 59 of 2000}}\)
The judgement of Melamet J, states;

The issue to be decided is whether the interest which accrued from the credits in the current account of the appellant at the A Bank fall within or outside the scope of the provisions of the Double Tax Agreement set out above.

It is trite that interest falls under the definition of 'gross income' in s1 of the Income Tax Act and as such is liable to taxation. It is the consideration received for the use of money or the provision of credit. A taxpayer has not to embark upon a business to earn interest before such interest becomes liable to taxation - he can be a passive player in earning such interest.

To escape taxation in the present instance it will have to be shown that the interest was income derived from the business of air transport to enjoy the exemption under the provisions of the Double Tax Agreement set out above. The meaning of the agreement must be determined according to the principles governing the interpretation of contracts in the Republic of South Africa. The court must determine what the language of the document would ordinarily be understood to mean. It matters not, in my view, that on proclamation the arrangements therein contained shall in so far as they relate to immunity, exemption, or relief from taxation in the Republic have the effect as if enacted in the Income Tax Act (s 108(2) refers). Passos Tax Treaty Law pp 67-8.

The meaning ascribed to 'derive 'in the Shorter Oxford English Dictionary when used in circumstances approximating to those in the present case is-'to come from something as its source'. A similar meaning is given to 'derived 'in certain of the cases referred to in Words and Phrases Legally Defined 3 ed Vol 2 at 51.

It falls to determine whether the source of interest incurred in issue is the business itself or whether there is some other source of such income.

Referring to the judgements in CIR v Black 1957 (3) SA 536 (A) at 543, and Commissioner of Taxes v William Dunn & Co Ltd 1918 AD 607 Melamet J was intending to distinguish the extent to which income earned by an ancillary business or venture should be regarded as a separate or part of the main business venture;

It must always be a matter of degree whether a particular item of revenue can be said to be ancillary and incidental to a business, and hence to be derived from that business, or whether there is a separate investment or undertaking.
Referring to the OECD Model Convention\(^1\) and Commentaries Melamet J further states:

The model convention of the Organisation for European Economic Co-operation and Development (OECD) has served as the basis for a veritable network of double taxation conventions existing between the Republic of South Africa and other countries and between many other countries inter se SIR v Downing 1975 (4) SA 518 (A) at 523. If regard is had to the OECD commentary on the convention in relation to profits from the operation of ships or aircraft in international traffic it is said that these cover income arising directly from the carriage of passenger and cargo and also other classes of income that are closely connected with such income. The ‘close connection’ may be based on the similar nature of the income arising from ancillary supplementary or incidental activities to the operation of the ship or aircraft. Passos, op cit pp 113-14.

We are of the opinion that on the principle laid down in the commentary to the OECD convention that the interest earned in the present case is from an ancillary activity if not part of the operation of the aircraft.

The principle contained by Article 8 is clearly that profits of the business shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated. Based on this principle the Commentaries then proceed to give an interpretation of what is to be regarded as ‘profits of the business operation’. Whilst the interpretation widely covers the activities of Air Transport it is interesting to note that paragraph 14 intended to apply to all forms of ‘Investment Income’ ie income from stocks, bonds shares or loans which is to be subjected to the treatment ordinarily applied to this type of income, except where the investment that generates the income is made as an integral part of the carrying on of the business of operating the ships or aircraft in international traffic in the Contracting State. The paragraph further states:

Thus, the Article…..it would not apply, however to interest income derived in the course of the handling of cash-flow or other treasury activities for permanent establishments of the enterprise to which the income is not attributable or for associated enterprises, regardless of whether these are located within or outside that Contracting State, or for the head office (centralization of treasury and investment activities), nor would it apply to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation.

Whilst the agreement departs significantly from that of the Model Tax Convention, Article 2 still refers to all income derived from the business of sea or air transport. In view of the reference made by paragraph 14 of the Commentaries to interest income generated by the short-term investment of the profits generated by the local operation of the business where the funds invested are not required for that operation, it may be questionable whether the interest earned by the ‘short term’ deposits of the surplus cash was attributable to the normal business operations.

\(^1\) At the time of the ITC 1503 case the applicable Model Convention and Commentaries were those as at 1977 which model was subsequently revised and amended as the 1992 Model Convention published in its present loose leaf format.
Extent to which a Treaty may conflict with the domestic tax laws

The objectives of a double tax treaty should be to facilitate the exchange of goods and services without attaching any encumbrances in the form of the imposition of taxes to the same income and at the same time provide against any undue loss or erosion of the tax base of either contracting states. The agreement may also provide for the prevention of tax avoidance and evasion (*OECD Model Tax Convention Commentaries (2003) Article 1 para 7*).

A double tax agreement may however be exploited by those taxpayers whose aims are to take advantage of possibly more favourable tax rates or exemptions provided by other tax regimes. As an example, if as a South African resident I invest my foreign exchange investment allowance\(^1\) overseas and earn say R50,000 in interest this amount would be included in my Gross Income and consequently taxable. Should I however use the allowance to form an overseas company which invests the sum and earns the same amount of interest then neither I nor the company would be subject to South African tax on such interest, whether or not the amount would be taxable in the foreign State obviously depends on the domestic laws of that State.

Should the home State e.g. South Africa decide to adopt legislation to counter this abuse the fundamental question arises as to whether any such specific provisions which are intended to prevent tax abuse conflict with the tax convention that may be in place with the other State.

The matter is addressed by the Commentaries\(^2\) at paragraphs 9.1 and 9.2 as follows:

9.1 This raises two fundamental questions that are discussed in the following paragraphs:

— whether the benefits of tax conventions must be granted when transactions that constitute an abuse of the provisions of these conventions are entered into (cf. paragraphs 9.2 and following below); and
— whether specific provisions and jurisprudential rules of the domestic law of a Contracting State that are intended to prevent tax abuse conflict with tax conventions (cf. paragraphs 22 and following below).

9.2 For many States, the answer to the first question is based on their answer to the second question. These States take account of the fact that taxes are ultimately imposed through the provisions of domestic law, as restricted (and in some rare cases, broadened) by the provisions of tax conventions. Thus, any abuse of the provisions of a tax convention could also be characterised as an abuse of the provisions of domestic law under which tax will be levied. For these States, the issue then becomes whether the provisions of tax conventions may prevent the application of the anti-abuse provisions of domestic law, which is the second question above. As indicated in paragraph 22.1 below, the answer to that second question is that to the extent these anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule, there will be no conflict between such rules and the provisions of tax conventions.

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\(^1\) Up to R750,000 allowable in terms of South African Exchange Control regulations  
\(^2\) OECD Model Tax Convention - Commentary on Article 1
Claims to tax treaty benefits by subsidiary companies, in particular companies established in tax havens or benefiting from harmful preferential regimes, may be refused where careful consideration of the facts and circumstances of a case shows that the place of effective management of a subsidiary does not lie in its alleged state of residence but, rather, lies in the state of residence of the parent company so as to make it a resident of that latter state for domestic law and treaty purposes (this will be relevant where the domestic law of a state uses the place of management of a legal person, or a similar criterion, to determine its residence) (Commentaries (2003) Art 1 para 10.1)

In certain respects what may be regarded as a conflict between a double tax treaty and areas of domestic tax laws may in fact be regarded as a paradox on the part of the latter. The Model Tax Convention may clearly prescribe a position in regards to the imposition of tax by one state in respect of income earned in another state yet the domestic laws of the local State could appear to override the treaty rules. This aspect of tax law is probably no more apparent than that in the interpretation of the Controlled Foreign Company provisions of s9D which appear to conflict with the Business Profits provisions contained in Article 7 of the Model Tax Convention.

The provisions of section 9D are effective in its amended form as from June 1 2004 and applicable in respect of the foreign tax year of a Controlled Foreign Company (CFC) which ends during any year of assessment commencing on or after that date. The provisions determine the proportional amount of the net income, of the CFC, to be included in the income of any resident who holds any participation rights in a controlled foreign company. A Controlled Foreign Company and Participation Rights are terms defined by s9D(1) whilst Net Income of the CFC is defined in terms of s9D(2A) and the currency conversion aspects, ie the rate at which the net income must be converted, dealt with under s9D(6).

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1 Model Tax Convention on Income and on Capital [January 2003]
2 Refer Revenue Laws Amendment Act No 45 of 2003
The provisions of s9D(2), at the outset, appear to be clear. The section reads

There shall be included in the income for the year of assessment of any resident who holds any participation rights in a controlled foreign company —

(a) on the last day of the foreign tax year of that controlled foreign company which ends during that year of assessment, an amount equal to—

(i) where that foreign company was a controlled foreign company for the entire foreign tax year, the proportional amount of the net income of that controlled foreign company determined for that foreign tax year, which bears to the total net income of that company during that foreign tax year, the same ratio as the percentage of the participation rights of that resident in relation to that company bears to the total participation rights in relation to that company on that last day;

Some may interpret the provisions of s9D(2) as nothing less than a clear contravention of Article 7 whilst others, it is submitted correctly, view the section as an anti avoidance provision with the purpose of imposing a notional tax on a resident of an amount calculated by reference to the income of another albeit non-resident company.

However whilst a double tax treaty may, in terms of Article 7, state that profits (in my above example, the interest earned less allowable expenses) of an enterprise of a Contracting State shall be taxable only in that State (that is the State of residence of my company) the provisions of s9D do not override the treaty by subjecting my income to a notional amount ‘based on the profits of my non resident company’.

The Committee of Fiscal Affairs address the matter in relation to base companies by the Commentary to Article 1 as follows:

Commentary on Article 1 paragraph 23.

The use of base companies may also be addressed through controlled foreign companies provisions. A significant number of Member and non-member countries have now adopted such legislation. Whilst the design of this type of legislation varies considerably among countries, a common feature of these rules, which are now internationally recognised as a legitimate instrument to protect the domestic tax base, is that they result in a Contracting State taxing its residents on income attributable to their participation in certain foreign entities. It has sometimes been argued, based on a certain interpretation of provisions of the Convention such as paragraph 1 of Article 7 and paragraph 5 of Article 10, that this common feature of controlled foreign companies legislation conflicted with these provisions. For the reasons explained in paragraphs 10.1 of the Commentary on Article 7 and 37 of the Commentary on Article 10, that interpretation does not accord with the text of the provisions. It also does not hold when these provisions are read in their context. Thus, whilst some countries have felt it useful to expressly clarify, in their conventions, that controlled foreign companies legislation did not conflict with the Convention, such clarification is not necessary. It is recognized that controlled foreign companies legislation structured in this way is not contrary to the provisions of the Convention.

[Bold Highlights Provided]
And further affirm their position by the Commentary to Article 7 as follows:

Commentary on Article 7, Paragraph 10.1
The purpose of paragraph 1 is to provide limits to the right of one Contracting State to tax the business profits of enterprises that are residents of the other Contracting State. The paragraph does not limit the right of a Contracting State to tax its own residents under controlled foreign companies provisions found in its domestic law even though such tax imposed on these residents may be computed by reference to the part of the profits of an enterprise that is resident of the other Contracting State that is attributable to these residents' participation in that enterprise. Tax so levied by a State on its own residents does not reduce the profits of the enterprise of the other State and may not, therefore, be said to have been levied on such profits (see also paragraph 23 of the Commentary on Article 1 and paragraphs 37 to 39 of the Commentary on Article 10).

The Bricom Case

Whilst there are no known decided cases in South African tax law regarding the Controlled Foreign Company (CFC) Provisions it is considered that any challenge to the provisions of s9D would prove futile not only in view of the OECD commentaries but in view of the decision by the UK Court of Appeal in the leading case of Bricom Holdings Limited v IRC 1997 STC 1179 CA.

The impact on the South African Legislature of the Bricom case may be seen in the changes effected to s9D(2), with regards to the references to “net income” as compared to the previous wording which referred to “investment income”.

Prior to its amendment\(^1\) s9D(2) read as follows:

There shall be included in the income of any resident contemplated in the definition of ‘controlled foreign entity’ in subsection (1), a proportional amount of any investment income received by or accrued to such entity, which bears to the total investment income received by or accrued to such entity, the same ratio as the percentage of the participation rights of such resident in relation to such entity bears to the total participation rights in relation to such entity: Provided that the provisions of this subsection shall not apply to any amount of investment income to which the provisions of subsection (4) are applicable.

\(^1\) Sub-s (2) substituted by s 19(1)(b) of Act 30 of 2000 with effect from 23 February 2000 and by s 10 (1) (f) of Act 59 of 2000 with effect from years of assessment commencing on or after 1 January 2001.
The section *(prior to the current provisions of s9D)*\(^1\) was amended to then read:

There shall be included in the income for the year of assessment of any resident contemplated in the definition of ‘controlled foreign entity’ in subsection (1), an amount equal to the proportional amount of the net income of such entity for the foreign tax year of such entity which ends during such year of assessment of such resident, which bears to the total net income of such entity during such foreign tax year, the same ratio as the percentage of the participation rights of such resident in relation to such entity bears to the total participation rights in relation to such entity: Provided that the provisions of this subsection shall not apply where such resident (together with any connected person in relation to such resident) in aggregate at all times during the foreign tax year holds less than 10 per cent of the participation rights and is entitled to exercise less than 10 per cent of the voting rights in such controlled foreign entity.

\[\text{Sub-s (2) substituted by s 19(1)(b) of Act 30 of 2000 with effect from 23 February 2000 and by s 10 (1) (f) of Act 59 of 2000 with effect from years of assessment commencing on or after 1 January 2001.}\]

The facts of the *Bricom* case are briefly as follows:

The Court had to decide whether or not the CFC rules of the UK domestic tax laws should be overridden by Article 11 of the UK/Netherlands double tax treaty. In accordance with the Model Tax Treaty the Article relates to interest earned in one State however beneficially owned by an enterprise resident in another State. The appellant sought to argue that in calculating the net income of the Controlled Foreign Company the interest earned by the CFC should not be included in the calculation on the basis of its exempt status in accordance with the provisions of Article 11 which reads as follows:

‘Interest arising in one of the States which is derived and beneficially owned by a resident of the other State shall be taxable only in that other State.’

Although deciding in favour of the respondent it is considered the judgement, whilst arriving at a conclusion in harmony with the OECD Model Commentaries, took a dissimilar approach to the problem. Both decisions of the Special Commissioners and the Court of Appeal focused on the concept of the income being taxed as that of notional income the amount of which was calculated by reference to the earnings of the CFC. That such income may have included interest was of no bearing on the calculation since the interest changed its character when calculating the hypothetical amount to be included in the taxable income of the appellant.

\[^1\text{S 9D substituted by s 22(1) of Act 45 of 2003 applying in respect of the foreign tax year of a controlled foreign company which ends during any year of assessment commencing on or after 1 June 2004.}\]
Referring to an interpretation of s747(6)(a) of the UK Income and Corporation Taxes\(^1\) act Millet LJ states:

The difficulty with this submission is that ‘the chargeable profits’ as defined by s 747(6)(a) are a purely notional sum. They do not represent any profits of Spinneys on which United Kingdom corporation tax is chargeable, for there are no such profits. Nor do they represent any actual payments or receipts of Spinneys, whether of interest or anything else. They are merely the product of a mathematical calculation made on a hypothetical basis and making counterfactual assumptions. The ‘chargeable profits’ which are defined by s747(6)(a) exist only as a measure of imputation. What is apportioned to the taxpayer company and subjected to tax is not Spinneys’ actual profits but a notional sum which is the product of an artificial calculation (emphasis added).

In his Judgement Millett LJ draws on assistance from the decisions in \textit{IRC v Australian Mutual Provident Society} [1947] AC 605, 28 TC 388 as explained by Lord Radcliffe in \textit{Ostime (Inspector of Taxes) v Australian Mutual Provident Society} [1960] AC 459 at 479, 38 TC 492 at 516. where he states:

In my judgment these cases show that the question turns on the nature of the statutory process. Interest from exempt securities does not cease to be such by being included as a component element of the recipient’s taxable profits (see Hughes). Exempt income does not change its character or lose its exemption merely because it is deemed to be the income of another person or is imputed to him (see Strathalmond). \textit{But where tax is charged on a conventional or notional sum which exists only as the product of a calculation, the fact that one of the elements in the calculation is measured by reference to the amount of exempted income does not make the exempted income the subject of the tax (see Australian Mutual Provident Society).} (Italics Added)

It was further stated:

Applying those principles to the present case, I am in no doubt that the Special Commissioners were correct to dismiss the taxpayer company's appeal. They held that the interest lost its character as interest by the end of stage 1. I do not regard that as an accurate description of the statutory process. It is rather a reflection of the Revenue's unsuccessful argument in Hughes, viz: that interest from exempt securities loses its character as interest by being included in the computation of the recipient's trading profits. The correct analysis is that the interest received by Spinneys is not included in the sum apportioned to the taxpayer company on which tax is chargeable. It merely provides a measure by which an element in a conventional or notional sum is calculated, and it is that conventional or notional sum which is apportioned to the taxpayer company and on which tax is charged.

Although the provisions of s9D have undergone extensive changes in the last year\(^2\) nonetheless these changes do not alter the substance of the legislation that is at countering the avoidance of income tax by the use of Controlled Foreign Companies. Any such provisions enacted by a State carry the support of the OECD Model Commentaries which confirm that such legislation aimed at the protection of the tax base would not necessarily create a conflict with a Double Tax Treaty.

\(^1\) By comparison s9D of the Income Tax Act
\(^2\) s22 of Act 45 of 2003 effective as from June 1 2004
CONCLUSION

The growth of international trade and services to and by South Africa, which arguably plays a pivotal role in the economic development and stability of the African continent, I believe is determined to a large extent by the acceptance by the Taxing Authorities of the existing norms and standards of the Double Tax Conventions. In their acceptance of the need for clarity on tax matters by any potential investor like most other States South Africa has preferred the OECD Model Tax Convention for its double tax agreements, possibly as a result of the dominance of trade and its history with the European States.

A double tax agreement is not meant to impose any tax of a State on the taxpayer of the other State other than that levied by the domestic tax laws, the agreement does not create a tax burden or command that a taxpayer must be subjected to a particular rate of tax. The agreement aims to prevent the same income earned in a State from being subjected to Taxes in both the State of source and State of residence of the taxpayer who is the beneficial owner of the income. At the worst the agreement in recognising the right of both States to tax the income, the income may then be subjected to tax at a ceiling as determined by the agreement or the agreement may call for the apportionment of such income to either State.

By its nature the double tax agreement aims to provide certainty to a taxpayer of either State as to the potential tax liability that may be imposed on its international transactions with a particular State. Since the OECD Model Agreement has been drafted in terms considered too wide by most States the OECD Committee on Fiscal Affairs then provided Commentaries to the Model Tax Convention which aim to provide some guidance and interpretation on the intentions of the drafters of its provisions. The overriding principle however in the interpretation of Double Tax Treaties is that which allows a reconciliation between the domestic laws of the contracting states and the obligations created by a DTA as concluded by the Republic. It appears however that a clear majority of courts in a number of countries, including the limited number of cases which have come before the South African courts, are accepting that double tax conventions are to be interpreted in accordance with the rules of international law applicable to the interpretation of treaties, and not by application of the rules applicable to domestic tax legislation.
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Thanks to Wally Horak, UCT Lecturer and International Tax Director at attorneys Sonnenberg Hoffman and Galombik, Cape Town for his useful comments and suggestions.

¹ All extracts from the Commentaries have been reproduced with the express permission of the OECD obtained through the Centre francais d’exploitation du droit de copie (CFC) at 20, rue des Grands-Augustins 75006 Paris France.
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CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA

1996 ACT 108 OF 1996
As adopted on 8 May 1996 and amended on 11 October 1996 by the Constitutional Assembly

ANNEXURE 2

International Law

International agreements

231. (1) The negotiating and signing of all international agreements is the responsibility of the national executive.

(2) An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).

(3) An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.

(4) Any international agreement becomes law in the Republic when it is enacted into law by national legislation; but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.

(5) The Republic is bound by international agreements which were binding on the Republic when this Constitution took effect.

Customary international law

232. Customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.

Application of international law

233. When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.
COMMENTARIES – INTRODUCTION

Paragraph

General remarks on the Model Convention

27. The Model Convention seeks, wherever possible, to specify for each situation a single rule. On certain points, however, it was thought necessary to leave in the Convention a certain degree of flexibility, compatible with the efficient implementation of the Model Convention. Member countries therefore enjoy a certain latitude, for example, with regard to fixing the rate of tax at source on dividends and interest, the choice of method for eliminating double taxation and, subject to certain conditions, the allocation of profits to a permanent establishment by apportionment of the total profits of the enterprise. Moreover, for some cases, alternative or additional provisions are mentioned in the Commentaries.

Commentaries on the Articles

28. For each Article in the Convention there is a detailed Commentary that is intended to illustrate or interpret its provisions.

29. As the Commentaries have been drafted and agreed upon by the experts appointed to the Committee on Fiscal Affairs by the Governments of Member States they are of special importance in the development of international fiscal law. Although the Commentaries are not designed to be annexed in any manner to the conventions signed by Member Countries they can nevertheless be of great assistance in the application and interpretation of the convention and in particular in the settlement of any disputes.

29.1 The tax administrations of Member States routinely consult the Commentaries in their interpretation of bilateral tax treaties. The Commentaries are useful both in deciding day to day questions of detail and in resolving larger issues involving the policies and purposes behind various provisions. Tax officials give great weight to the guidance contained in the Commentaries.

29.2 Similarly, taxpayers make extensive use of the Commentaries in concluding their business and planning their business transactions and investments. The Commentaries are of particular importance in the Countries that do not have a procedure for obtaining an advance ruling on tax matters from the tax administrations as the Commentaries may be the only available source of interpretation in that case.

29.3 Bilateral tax treaties are receiving more and more judicial attention as well. The courts are increasingly using the Commentaries in reaching their decisions. Information collected by the Committee on Fiscal Affairs shows that the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the Judges deliberations. The Committee expects this trend to continue as the worldwide network of tax treaties continues to grow and as the Commentaries gain even more widespread acceptance as an important interpretive reference.

30. Observations on the Commentaries have sometimes been inserted at the request of members countries that are unable to concur in the interpretation given in the Commentary on the Articles concerned. These observations thus do not express any disagreement with the text of the Convention, but usefully indicate the way in which those countries will apply the provisions of the Article in question. Since the observations are related to the interpretations of the Articles given in the Commentaries, no observation is needed to indicate a country’s wish to modify the wording of an alternative or additional provision that the Commentaries allow countries to include in their bilateral conventions.