



A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation)

**TAXATION OF OFFSHORE HYBRID ENTITIES:
THE SOUTH AFRICAN PERSPECTIVE**

Applicant:	Louisa Tlale
Student number:	693713
Supervisor:	Mr Roy Blumenthal
Head of School:	Prof N Padia
Degree:	Master of Commerce (specialising in Taxation)
Date:	31 March 2014

ABSTRACT

This research report examines how the classification and taxation of offshore hybrid entities from a South African tax perspective compares to international approaches. It analysis the concept of hybrid entities, discusses the issues arising from the use of these entities in cross-border activities. It then examines international approaches as recommended by the Organisation for Economic Co-operation and Development ('OECD') and adopted by selected jurisdictions to compare with the foreign partnership legislation introduced into the South African tax system. The conclusion reached is that the South African classification and taxation of hybrid entities is aligned with some international approaches but consideration has to be made to the practical application of this legislation in order to eliminate any further uncertainties. It also recommends consideration for a balance between anti-avoidance and international competitiveness for the South African investor.

Key words: hybrid entity, fiscally transparent entity, fiscal transparency, foreign partnership, taxing hybrid entities, South African foreign partnership, re-designation to foreign partnership, double non-taxation, tax arbitrage, hybrid mismatch arrangement.

DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

Louisa Tlale

31 March 2014

TABLE OF CONTENTS

	Page
ABSTRACT	II
DECLARATION	III
1 INTRODUCTION	1
1.1 BACKGROUND.....	1
1.2 RESEARCH PROBLEM	3
1.2.1 THE STATEMENT OF THE PROBLEM	3
1.2.2 THE SUB-PROBLEMS	4
1.3 RESEARCH GOALS.....	5
1.4 PURPOSE OF THE RESEARCH.....	5
1.5 SIGNIFICANCE OF THE STUDY.....	5
1.6 RESEARCH METHODOLOGY	6
1.7 CHAPTER OUTLINE	6
1.8 SUMMARY	8
2 THE CONCEPT OF HYBRID ENTITIES.....	9
2.1 INTRODUCTION	9
2.2 TERMS	9
2.2.1 HYBRID	9
2.2.2 HYBRID ENTITY	9
2.2.3 FISCALLY TRANSPARENT ENTITY	10
2.2.4 PARTNERSHIP	10

2.3 THE DISTINCTION BETWEEN A HYBRID/FISCALLY TRANSPARENT ENTITY AND A PARTNERSHIP	11
2.4 FISCALLY TRANSPARENT ENTITIES IN SELECTED JURISDICTIONS.....	11
2.4.1 UNITED STATES OF AMERICA.....	11
2.4.2 UNITED KINGDOM.....	12
2.4.3 CANADA	13
2.4.4 FRANCE.....	14
2.4.5 GERMANY	14
2.5 REASONS FOR FORMING A HYBRID ENTITY.....	15
2.5.1 NON-TAX REASONS FOR FORMING A HYBRID ENTITY	15
2.5.2 POSSIBLE TAX REASONS FOR FORMING A HYBRID ENTITY	16
2.6 CONCLUSION.....	16
3 ISSUES ARISING FROM THE USE OF HYBRID ENTITIES	18
3.1 INTRODUCTION	18
3.2 CHALLENGES ARISING FROM THE USE OF HYBRID ENTITIES	18
3.2.1 CLASSIFICATION OF THE HYBRID ENTITIES FOR TAX PURPOSES.....	18
3.2.2 RESIDENCE ISSUES	19
3.2.3 DOUBLE TAXATION.....	20
3.2.4 DOUBLE NON-TAXATION.....	21
3.2.5 UNINTENDED TREATY BENEFITS.....	22
3.2.6 THE POSSIBILITY OF AVOIDING THE ‘CONTROLLED FOREIGN COMPANY’ LEGISLATION.....	22
3.3 CONCLUSION.....	22
4 INTERNATIONAL APPROACHES TO TAXING HYBRID ENTITIES AS RECOMMENDED BY THE OECD	24
4.1 INTRODUCTION	24

4.2 THE REPORTS PUBLISHED BY THE OECD	24
4.2.1 THE PARTNERSHIPS REPORT	24
4.2.2 THE HYBRID MISMATCH REPORT.....	25
4.3 CONCLUSION.....	26
5 INTERNATIONAL APPROACHES TO TAXING HYBRID ENTITIES AS ADOPTED BY SELECTED JURISDICTIONS.....	27
5.1 INTRODUCTION	27
5.2 CLASSIFICATION AND TAX TREATMENT OF FOREIGN HYBRID ENTITIES IN THE SELECTED JURISDICTIONS	27
5.2.1 UNITED STATES OF AMERICA.....	28
5.2.2 CANADA	30
5.2.3 UNITED KINGDOM.....	32
5.2.4 GERMANY	34
5.2.5 NETHERLANDS.....	37
5.2.6 DENMARK	40
5.3 CONCLUSION.....	42
6 TAXATION OF HYBRID ENTITIES FROM A SOUTH AFRICAN PERSPECTIVE .	43
6.1 INTRODUCTION	43
6.2 INTRODUCTION OF THE NEW FOREIGN PARTNERSHIP DEFINITION	43
6.2.1 DEFINITION OF FOREIGN PARTNERSHIP IN SECTION 1 OF THE ACT	44
6.2.2 OTHER AMENDMENTS TO THE SOUTH AFRICAN LEGISLATION.....	45
6.2.2.1 DEFINITION OF COMPANY CONTAINED IN SECTION 1 OF THE ACT	45
6.2.2.2 DEFINITION OF PERSON CONTAINED IN SECTION 1 OF THE ACT	46
6.2.3 AMENDMENTS TO SECTION 24H.....	46
6.3 TAX CONSEQUENCES OF THE NEW FOREIGN PARTNERSHIP DEFINITION ...	47

6.3.1	IMPACT ON SOUTH AFRICAN INVESTORS IN FOREIGN COMPANIES.....	49
6.3.2	IMPACT ON DISTRIBUTION OF PROFITS	50
6.3.3	IMPACT ON FOREIGN TAX CREDITS.....	51
6.3.4	IMPACT ON TAX LOSSES.....	51
6.3.5	ADMINISTRATIVE BURDEN	52
6.4	CHALLENGES OF APPLYING THE FOREIGN PARTNERSHIP DEFINITION	53
6.4.1	EXIT CHARGES.....	53
6.4.2	ASSET TAKE-ON BALANCES	54
6.4.3	CAPITAL ALLOWANCES ON ACQUIRED ASSETS	55
6.5	THE SOUTH AFRICAN APPROACH IN COMPARISON TO OTHER INTERNATIONAL APPROACHES	57
6.6	ANTI-ABUSE RULES	60
6.7	INTERNATIONAL COMPETITIVENESS	60
6.8	CONCLUSION.....	61
7	CONCLUSION.....	63
7.1	INTRODUCTION	63
7.2	RESEARCH FINDINGS.....	63
7.3	RECOMMENDATIONS.....	68
7.3.1	ANTI-ABUSE RULES	68
7.3.2	INTERNATIONAL COMPETITIVENESS	69
7.4	CONCLUSION.....	69
8	REFERENCE LIST	70
8.1	BOOKS.....	70
8.2	JOURNALS.....	70
8.3	ARTICLES.....	71

8.4 GOVERNMENT PUBLICATIONS.....	75
8.5 CONFERENCE PROCEEDINGS	76
8.6 TABLE OF CASES.....	76

1 INTRODUCTION

1.1 Background

Offshore hybrid entities, often referred to as ‘hybrid entities’ have become a popular tool for international tax planning (Ruchelman, 2008:1). For a number of years the Organisation for Economic Co-operation and Development (‘OECD’) has been concerned with what it describes as aggressive tax planning which includes untaxed income, multiple deductions and other forms of international tax arbitrage. This area is a growing concern for all tax authorities. The OECD had in recent years focused on corporate assessed losses and has now turned its attention to hybrid mismatches. The OECD’s concerns in this area has now been restated on a wider theme of ‘base erosion profit shifting’ used within the OECD to describe this general area of focus. (PWC, 2012:4). The OECD’s general area of focus is discussed in a recently issued report entitled ‘Addressing Base Erosion and Profit Shifting’ (‘BEPS’) in which it has concluded on certain key focus areas that need to be tackled, amongst these are hybrid mismatch arrangements.

In the OECD report entitled ‘Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues’, the OECD defines hybrid mismatch arrangements to be arrangements exploiting differences in the tax treatment of transactions, instruments, entities or transfers between two or more countries (OECD, 2012:5). The OECD further comments that these arrangements often lead to ‘double non-taxation’ that may not be intended by either country, or may alternatively lead to a tax deferral which if maintained over several years is economically similar to double non-taxation. Therefore, they raise a number of tax policy issues, affecting for example tax revenue, competition, economic efficiency, transparency and fairness. (OECD, 2012:11).

The OECD has discussed issues arising from hybrid mismatch arrangements or international arbitrage strategies. It describes the main elements of hybrid mismatch arrangement to include hybrid entities (that is, entities that are treated as transparent for tax purposes in one country and as non-transparent in another country), dual residence entities (that is, entities that are resident in two different countries for tax purposes),

hybrid instruments (that is, instruments which are treated differently for tax purposes in the countries involved and the most prominently as debt in one country and as equity in another country) and hybrid transfers (that is, arrangements that are treated as transfer of ownership of an asset for one country's tax purposes but not for tax purposes of another country, which generally sees a collateralized loan). (OECD, 2012:7 and cited by Correia, 2013:2). This research report will be limited to discussions relating to the hybrid entities.

The use of hybrid entities as a tool to conduct cross-border activities has become popular in recent years which has necessitated the review and reassessment of these cross-border structures by revenue authorities. This has raised concerns for the OECD, revenue authorities and tax policy makers that these cross-border structures, that are often complex, lead to unintended or distortive tax consequences for the taxpayer. The difficulties of dealing with hybrid entities arise from the fact that different countries may classify an entity differently in their domestic law. (Oguttu, 2009:52). Classification is required to determine the nature of the taxable income, the timing of taxation, and the possible availability of a foreign tax credit on the distributed income. In the context of a tax treaty, the classification of an entity is important to determine whether the entity is a resident of the other contracting state. This is necessary, for instance, to ensure that the tax treaty rates of withholding tax on dividends, interest and royalties apply. (Oguttu, 2009:52). The problems that can arise from the different classifications of partnerships or corporate hybrid structures are for example, the tax treatment of partnerships (as corporate structures) and the taxation of partners create possibilities of tax avoidance, double taxation and non-taxation of income (Oguttu, 2009:58).

There are various international approaches available to address challenges posed by the hybrid entities with regard to their classification and taxation that have been adopted by certain foreign jurisdictions. The research report will only examine certain of these approaches.

In South Africa, the topic of the taxation of hybrid entities had received little attention, and there was no legislation in place, prior to 24 August 2010, dealing with the taxation of these entities. Meanwhile, a number of South African residents have been known to invest in offshore hybrid entities whereby it is possible to avoid South African taxes on

their income. (Oguttu, 2009:52). There were various challenges experienced by South African taxpayers with investments in hybrid entities as a result of not having legislation in place dealing with classification and taxation of hybrid entities. The challenges experienced include the classification of hybrid entities in the South African Income Tax Act ('the Act') due to anomalies created by the definition of company (that is, a legal person), challenges of applying controlled foreign companies ('CFC') legislation to hybrid entities and challenges of determining the residence status of a hybrid entity (Oguttu, 2009:58) which will be discussed in detail in the research report.

A definition of 'foreign partnership' in section 1 of the Act, has now been introduced into the South African income tax legislation. This definition seeks to provide certainty on the tax treatment of foreign hybrid entities ('Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010':86). Essentially, if a corporation or entity is treated as a conduit for tax purposes in the foreign jurisdiction (that is, the partners/members are required to take into account their interest in amounts received by or accrued to the partnership when such amounts are received by or accrue to the partnership), the South African tax system will also treat it as a conduit (La Grange, 2011). This entity will now be classified and referred to as a 'foreign partnership', as defined in section 1 of the Act, for South African tax purposes. Accordingly, the foreign partnership will not be treated as a company for South African income tax purposes but rather as a partnership in terms of section 24H of the Act where the partners/members are required to take into account their interest in amounts received by or accrued to the partnership when such amounts are received by or accrue to the partnership (La Grange, 2011). Various other provisions including 'company' and 'person' definitions in section 1 and section 24H(1) and (5)(a) of the Act have been amended to ensure consistent application of the foreign partnership principles.

1.2 Research problem

1.2.1 The Statement of the Problem

How does the approach adopted by South Africa to taxing hybrid entities compare to international approaches as recommended by the OECD or those adopted by selected foreign jurisdictions? This research report will examine international approaches of the OECD and selected countries and compare these approaches to the legislation

introduced by South Africa for classification and taxation of hybrid entities. This research report also seeks to unpack the operation, implications and challenges of applying the new foreign partnership tax legislation from a South African tax perspective.

1.2.2 The Sub-Problems

The first sub-problem is to analyse the concept of hybrid entities. The focus is to differentiate these entities from similar structures in certain jurisdictions and to determine why such entities are created.

The second sub-problem is to discuss the issues arising from the use of hybrid entities. This covers a range of issues including the classification of hybrid entities, challenges of taxing hybrid entities, tax arbitrage opportunities, unintended tax consequences of double non-taxation or double taxation, determination of residency and eligibility for tax treaty benefits.

The third sub-problem is to examine the international approaches to taxing hybrid entities as recommended by the OECD. These approaches have been discussed by the OECD as part of the tax policy and compliance issues.

The fourth sub-problem is to examine the approaches to taxing hybrid entities as adopted by selected jurisdictions such as the United States of America, the United Kingdom, Canada, Germany, the Netherlands and Denmark. The challenges experienced and related case law will be discussed with regard to the approaches adopted for some of these countries.

The fifth sub-problem is to examine and compare the approach introduced into the South African tax legislation for classification and taxation of hybrid entities. As this is new legislation, part of this sub-problem is to understand how the South African approach of classifying and taxing hybrid entities actually operates, the implications and challenges of applying the new foreign partnership tax legislation. As the introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes, how should this balance be achieved?

1.3 Research goals

The research report will aim to achieve the following overall goal:

This research will examine how the classification and taxation of offshore hybrid entities from a South African tax perspective compares to international approaches. To achieve this goal, the report will analyse the concept of hybrid entities, discusses the issues arising from the use of these entities in cross-border activities. It will then examine international approaches as recommended by the OECD and adopted by selected jurisdictions to compare with the foreign partnership legislation introduced into the South African tax system. As this is new legislation, the secondary goal of this research is to understand how the South African approach of classification and taxation of hybrid entities actually operates, the implications and challenges of applying the new foreign partnership tax legislation. The introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes, how should this balance be achieved?

1.4 Purpose of the research

This research report will, primarily, compare the international approaches of classification and the taxation of hybrid entities as recommended by the OECD or those adopted by selected foreign jurisdictions to the South African approach. This comparative study is designed to draw on the experience with the widely differing approaches in order to determine whether the South African tax legislation on foreign partnerships effectively addresses the classification and taxation of hybrid entities and where appropriate, to adopt or adapt certain practices. As the concept of foreign partnership is new legislation from a South African perspective, the research report also considers aspects of the operation of the foreign partnership tax legislation.

1.5 Significance of the study

In South Africa, the topic of classification and taxation of hybrid entities has received little attention. Other than the leading South African international tax textbook, 'International Tax: A South African Perspective', authored by Professor Lynette Olivier

and Mr Michael Honiball and a few other articles, the most notable being ‘The Challenges of Taxing Investments in Offshore Hybrid Entities: A South African Perspective’ authored by Professor Annet Wanyana Oguttu, which was published prior to the introduction of foreign partnership tax legislation, there is no single authority in South Africa that comprehensively deals with classification and taxation of hybrid entities from a South African perspective with particular focus on the application of the new foreign partnership legislation introduced in the South African tax legislation. This research expands on the work done by these authors.

1.6 Research methodology

The research method adopted consists of a literature review of the relevant provisions of the Act, publications by the South African National Treasury relevant to this research, South African and international textbooks, journal articles, policies, guidelines, legislation and case law as well as international treaties relating directly to the objective of this research.

1.7 Chapter outline

Chapter 1: Introduction

This chapter provides the background, research problem, sub-problems, research goals, purpose of the research, significance of the research, the research methodology and sets out the chapter outlines.

Chapter 2: The concept of hybrid entities

This chapter defines the following terms: hybrid, hybrid entity, fiscally transparent entity, partnership. It provides the distinction between a hybrid/fiscally transparent entity and a partnership. It discusses a few examples of fiscally transparent entities in selected jurisdictions. Finally it provides some of the reasons for forming or the use of hybrid entities.

Chapter 3: Issues arising from the use of hybrid entities

This chapter discusses the issues that arise from the use of hybrid entities and the purpose of classifying these entities. It discusses the challenges experienced by tax authorities in taxing hybrid entities, the focus of this section is on issues of

classification, residency and the unintended tax consequences of double non-taxation, double taxation of cross-border activities and tax arbitrage opportunities.

Chapter 4: International approaches to taxing hybrid entities as recommended by the OECD

The chapter will examine the international approaches to taxing hybrid entities as recommended by the OECD. The focus will be on the publications issued by the OECD with regard to tax policy and compliance issues, namely the 'Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues' report (2012) and 'Addressing Base Erosion and Profit Shifting' (2013) report. This chapter will highlight the significance of hybrid mismatch in the OECD project.

Chapter 5: International approaches to taxing hybrid entities as adopted by selected jurisdictions

This chapter discusses the approaches to classification and taxation of hybrid entities as adopted by selected countries including the United States of America, Canada, the United Kingdom, Germany, the Netherlands and Denmark.

Chapter 6: Taxation of hybrid entities from a South African Perspective

The chapter focuses on the South African tax treatment of hybrid entities, covering:

- the new definition of foreign partnership and the amendments to various other sections in the Act;
- the background for the adoption of this treatment;
- the tax consequences of the new foreign partnership definition with particular focus of its impact on partnership members of foreign companies, distribution of profits, foreign tax credits, tax losses the increased administrative compliance burden;
- the challenges of applying new foreign partnership definition for pre-existing entities;
- the comparison of the South African approach to the international approaches;
- consideration of whether South Africa should adopt the anti-abuse rules; and
- the recommendation of what can be introduced in conjunction with the foreign partnership definition to ensure South African residents remain internationally competitive.

Chapter 7: Conclusion

This chapter will link the previous chapters and summarise the findings of the research.

1.8 Summary

The purpose of this chapter was to provide the background and introduces the reader to the research problem and sub-problems, research goals, purpose of this research report, the significance of the study, the methodology used to answer the research question and the overview of the chapter outline.

2 THE CONCEPT OF HYBRID ENTITIES

2.1 Introduction

This chapter will define the following terms: hybrid, hybrid entity, fiscally transparent entity and partnership. The distinction between a hybrid/fiscally transparent entity and a partnership will also be discussed.

This chapter will discuss the different forms of fiscally transparent entities in selected jurisdictions such as the Limited Liability Companies ('LLC') in the United States of America, Limited Liability Partnerships ('LLP') in the United Kingdom, Unlimited Liability Company ('ULC') in Canada, 'société en nom collectif' ('SNC') under the French Laws and the German 'GmbH & Co KG'. The 'GmbH & Co KG' is a form of German partnership with at least two partners; a partner that is a Limited Partnership referred to as 'Kommanditgesellschaft' ('KG') and another that is a Limited Liability Company referred to as 'Gesellschaft mit beschränkter Haftung' ('GmbH') as the general partner, the unlimited liability partner in the partnership.

This chapter will also discuss both the non-tax reasons and possible tax reasons for forming hybrid entities.

2.2 Terms

2.2.1 Hybrid

A cross-border hybrid occurs when two or more jurisdictions treat the same transaction, instrument, transfer, or entity differently or inconsistently (Krahmal, 2005:99).

2.2.2 Hybrid entity

The term hybrid entity is generally used to refer to a legal relationship that is treated as a corporation in one jurisdiction and as transparent, usually a partnership, in another

jurisdiction (Arnold and McIntyre, 2002:144). It is characterised differently for income tax purposes in different tax jurisdictions (Olivier and Honiball, 2011:844). For example, under the laws of Country A, it may be possible to establish a form of business organisation in which the members own interests and have limited liability. Country A may treat this organisation as a partnership for income tax purposes, with the result that the members or partners are taxable on their share of the income of the organisation. In contrast, under the laws of Country B, the organisation itself may be characterised as a corporation, as a legal entity separate from its members or shareholders, with the result that the organisation itself is subject to tax on its income. Hybrid entities usually take the form of trusts or partnership structures. (Arnold and McIntyre, 2002:144).

2.2.3 Fiscally transparent entity

A fiscally transparent entity is one that has its corporate veil pierced for income tax purposes and profits and losses are attributed directly to the shareholders or members of the entity. Alternatively, an entity is fiscal transparent when, due to its legal nature, it is not subject to income tax, for example a partnership or a trust in some jurisdictions. (Olivier and Honiball, 2011:842). For the purposes of this research, the term fiscally transparent entity will be used to refer to a hybrid corporation or a hybrid partnership rather than to partnerships or trusts.

2.2.4 Partnership

A partnership in its simplest form may be defined as an agreement or understanding, between two or more parties, where the parties agree to operate in a manner which furthers their mutual interests. The parties to the agreement of partnership are termed as 'partners' of the partnership. Such agreements for partnership may be oral or written, depending upon the laws of the country under which the partnership is organised. Another way to define a partnership is as a relationship existing between two or more persons who join to carry on a specific purpose like trade, business etc. (Sharma and Sharma, 2013:467).

A partnership exists when at least two persons enter into an agreement with the common goal of making a profit for all parties. Unlike the position in respect of a corporation, a partnership cannot have a single member. A partnership is not a separate legal entity, but constitutes an agreement between the parties. (Olivier and Honiball, 2011:162).

For a long period of time, partnerships have been popular vehicles for running most types of businesses in both countries with civil law and common law systems. Over the years, various countries have developed different variants of partnerships and therefore the characteristics of a partnership vary depending on the laws under which it is organised and also the legal system prevalent in the country of their organisation. (Sharma and Sharma, 2013:467).

2.3 The distinction between a hybrid/fiscally transparent entity and a partnership

Partnerships typically only have partners who are responsible for the management, affairs of the partnership and are responsible for the liabilities of the partnership and for each of the other partners. The finer characteristics of a partnership depend on the specific laws of the jurisdiction concerned. (Sharma and Sharma, 2013:469).

On the other hand, fiscally transparent entities which are mainly in the form of Limited Liability Corporations or Limited Liability Partnerships in many jurisdictions are different from partnerships as all of its partners have limited liability. Fiscally transparent entities combine the features and, in particular, the advantages of a company and partnership. Fiscally transparent entities are thought to be suitable as business vehicles where the investors wish to take an active role in the management of the business. (Sharma and Sharma, 2013:469).

2.4 Fiscally transparent entities in selected jurisdictions

There is a wide variety of hybrid entities. Below is a discussion of the various entities in selected jurisdictions that generally take the form of hybrid entities as they have attributes of both corporations and partnerships.

2.4.1 United States of America

The 'Limited Liability Company' ('LLC') in the United States of America is recognized as a corporate entity in the United States of America but classified as a partnership for income tax purposes (Oguttu, 2009:67). This classification is as a result of an election made through the check-the-box regulations in the United States of America. Check-the-box is the ability which the United States of America's tax residents have to elect if they wish a local or foreign entity to be viewed either as a transparent entity or non-transparent entity from a tax perspective (Olivier and Honiball, 2011:839). A check-the-box election cannot be made with respect to certain entities that are clearly corporations (so-called 'per se corporations'). The election can be made with respect to LLCs, partnerships, joint ventures, branches. (Arnold and McIntyre, 2002:146).

2.4.2 United Kingdom

The Limited Liability Partnership ('LLP') in the United Kingdom exists as a corporate entity. The LLP comes into existence upon incorporation. It is a body corporate with legal personality separate from that of its members. It combines the organisational flexibility and taxation treatment of a partnership but with limited liability for its members. It is thus seen as a hybrid entity based substantially on the corporation model. In essence it is a body corporate with limited liability in the sense that its members are not personally liable for its debts beyond their financial interests in the LLP itself. It is incorporated by registration with an incorporation document thus fulfilling the role of the memorandum of association and subject to many of the accounting and disclosure requirements and other controls applicable to companies. But it has no shareholders or share capital, no directors, and no specific requirements as to meetings or resolutions. (Oguttu, 2009:64).

In the United Kingdom, partnerships are governed by the Partnership Act 1890. In terms of this Act, partners in a firm are jointly and severally liable for all the debts and obligations of the partnership. The problem with partnerships in terms of this Act is that an individual partner's personal assets are at risk from claims arising out of actions of partners that may exceed not only the firm's insurance cover, but also the ability of the firm to meet the quantum of the claim from its own resources. To counteract the disadvantages of partnerships, the LLP structure was created. (Oguttu, 2009:64).

In general, partnership law in the United Kingdom does not apply to a LLP, but the arrangements between the partners may closely follow a traditional partnership agreement. For example, LLPs are run like general partnerships and they have a similar degree of management flexibility. The LLP's existence as a corporate entity means that the effect of the general law is different in comparison with a partnership. (Oguttu, 2009:64).

2.4.3 Canada

The Unlimited Liability Corporation ('ULC') in Canada is a corporate structure that permits a company to be incorporated with the flow of all profits and losses to shareholders. The ULC shelters shareholders from liability in most circumstances except upon liquidation of the company. Shareholders or past shareholders that disposed of their shares less than one year before liquidation become liable for the debts of the company. (Investopedia US, 2014).

The Canadian provinces of Alberta, British Columbia and Nova Scotia allow for the creation of ULCs under their respective statutes. A ULC is a hybrid entity as it is treated as a corporation for Canadian tax purposes and can be treated as a flow-through or disregarded entity in other jurisdictions such as the United States of America. (Severino, 2012).

An ULC may be an attractive vehicle for an investor from the United States of America expanding into Canada for reasons that may include:

- It avoids double taxation in the United States of America, as unlike Canada, the United States of America does not provide full integration between corporation and personal taxation that may arise in corporate structures;
- It allows for losses to flow through to the shareholders to offset a United States of America shareholder's income;
- It allows for investment in passive investments in Canada without triggering United States of America anti-avoidance rules for foreign holding companies;
- It provides flexibility to defer United States of America's income tax on the ULC's income (Canadian tax rates are lower than United States of America's tax rates) by allowing United States of America shareholders to elect to check-the-box to treat the ULC as a corporation for United States of America's income tax purposes so

that the ULC income will not be taxed in the United States of America until it is repatriated; and

- It has less stringent requirements to have Canadian directors (Severino, 2012).

2.4.4 France

Under French law, a ‘Société en Nom Collectif’ (‘SNC’) has separate legal personality although the partners are jointly and severally liable for its debts and obligations. Under French tax law, however, a SNC can elect to be taxed as a corporation. If another country treats the French SNC as a partnership, then residents of that other country with interests in the SNC would be treated as partners. Thus, if a French SNC borrows funds for use in its business, the interest will be deductible in computing the SNC’s income. If the owners of the SNC are residents of a country that treats the SNC as transparent, the interest deduction will also be available to those owners in their country of residence. In effect, the SNC can be used to obtain an interest deduction in both countries, significantly reducing the after-tax cost of financing. (Arnold and McIntyre, 2002:144 also cited in Oguttu, 2009:51).

2.4.5 Germany

The German ‘GmbH & Co KG’ which is a form of partnership with at least two partners; one that is a limited partnership ‘Kommanditgesellschaft’ (‘KG’) and another that is a limited liability company ‘Gesellschaft mit beschränkter Haftung’ (‘GmbH’) as the general partner, the partner with unlimited liability in the partnership. The GmbH & Co KG is a form of fiscally transparent entity in Germany. The limited partnership with a limited liability company as general partner is a German law and tax construct, it is a combination of the advantages of a partnership and the exclusion of liability of a limited liability company. (SH+C German Auditors and Tax Advisors). The GmbH & Co KG is a partnership and is a variation of the usual partnership Kommanditgesellschaft (KG), as it has legal capacity and the capacity to sue and be sued. The corporation form of the GmbH & Co KG offers a great deal of room for maneuver in terms of company law and tax law. (GRP Rainer Lawyers and Tax Advisors).

The GmbH & Co KG is a separate form of the limited partnership where the general partner is not an individual but a limited liability company, thereby minimising the financial risk to the individual. It is advisable to have a written partnership agreement between the general partner, the partner with unlimited liability, and the limited partners. Usually the shareholders of the limited liability company are identical to those of the limited partners of the limited partnership. (Low-Tax Global Tax & Business Portal).

The general partner, a limited company, often does not take part in the sharing of profits of the partnership and its shares are held by limited partner who can be authorized by the general partner by power of attorney to manage the partnership without losing their limited liability. In this way either as limited partners or as shareholders to the limited company all have limited liability, but the partnership is transparent for tax purposes. (Jones et al, 2002:304).

2.5 Reasons for forming a hybrid entity

2.5.1 Non-tax reasons for forming a hybrid entity

The use of hybrid entities is common in international structures and is commonly used by Venture Capital Funds and Collective Investment Vehicles. There are various business reasons for using hybrid entities, including:

- Flexibility in operations, unlike a company, a hybrid entity generally does not require a distinction between the owners of the company (its shareholders) and its managers (directors);
- The partners have better control over management;
- Limited liability for debts and obligations - members of hybrid entities in most jurisdictions, benefit from the limited liability, and so their own personal assets will be protected whilst those of the hybrid entity will be at risk;
- Flexibility in international tax planning;
- Tax protection for retained profits: these may be allocated as a profit share of the corporate member. The profits are 'distributed' as the share of profits to the members rather than distributed as dividends that are generally subject to withholding taxes;

- Flexible exit arrangements. The partnership agreement may provide that the corporate member's capital entitlement on a sale is similar to that of a preference shareholder's: the hybrid entity is entitled to a return of capital only;
- Where there is possible access to special tax reliefs, the hybrid entity can claim those reliefs. (Ingles, 2013:12 and Taneja, 2006:5).

2.5.2 Possible tax reasons for forming a hybrid entity

The tax treatment of the LLP creates opportunities for tax avoidance, especially in a tax treaty context (Oguttu, 2009:56).

For example, following promulgation of the check-the-box regulations in the United States of America, observant cross-border tax planners discovered that hybrid entities could be used to secure tax treaty benefits that clearly seemed inappropriate as a matter of policy. For example, under one popular structure, a Canadian parent corporation would hold debt of its subsidiary in the United States of America through a wholly owned limited liability company (LLC). When the subsidiary paid interest to the LLC, the interest was treated, for United States of American tax purposes, as income of the Canadian parent corporation, and a reduced rate of withholding tax was claimed under Article XI (Interest) of the United States of America-Canadian Tax Treaty. (Miller and Zhang, 2010).

The allowance of tax treaty benefits seemed improper as a matter of tax treaty policy, because Canada considers the LLC to be a corporation and therefore did not consider the Canadian parent corporation to have earned any interest income, so there was no current tax in Canada on the interest for which United States of America's tax treaty benefits were being claimed. Moreover, there was not even a deferred tax in Canada. When the LLC later transferred funds to the Canadian parent, such transfers were characterised as dividends and excluded from income for Canadian tax purposes. (Miller and Zhang, 2010).

2.6 Conclusion

The purpose of chapter was to address the first sub-problem of this research study which was to analyse the concept of hybrid entities. The focus was to understand the various terms associated with hybrid entities, differentiate these entities from similar structures in certain jurisdictions and to determine why such entities are formed.

It is clear that the hybrid entities may take on a variety of forms depending on the jurisdiction in which it was established. Now that the concept of hybrid entities has been established, the next step is to determine what the challenges experienced by tax authorities and investors in cross-border activities from the use of these hybrid entities.

3 ISSUES ARISING FROM THE USE OF HYBRID ENTITIES

3.1 Introduction

This chapter will discuss the challenges that arise from the use of hybrid entities, the challenges experienced by tax authorities in taxing hybrid entities and the purpose of classifying these entities for tax purposes.

The focus of this section will be on the unintended tax consequences of double non-taxation of cross-border activities and tax arbitrage opportunities.

3.2 Challenges arising from the use of hybrid entities

3.2.1 Classification of the hybrid entities for tax purposes

Classification of an entity for tax purposes is needed by the source state in which another state's entity is doing business in to determine whether to tax the entity or its members, the rate of tax, taxable income and in addition, where there is a tax treaty, whether the entity is a resident of the source state for purposes of the tax treaty. Classification is also required by the residence state of a partner in a hybrid entity formed under the law of another state to determine what type of income to tax, whether profits or dividends, the timing of taxation, when the income is earned or distributed, the cost base of assets in cases where co-ownership is taxed differently from partnerships, and whether foreign tax credits are available for the underlying tax. (Jones et al, 2002:288).

The hybrid attributes of fiscally transparent entities make their classification difficult in cross border transactions. The classification rules may differ from one jurisdiction to another as will be illustrated in Chapter 5 below. Not all jurisdictions have rules specifically dealing with or prescribing the classification of hybrid entities and the absence of these rules may result in issues of classification and taxation of hybrid entities.

In most jurisdictions classification is based on civil or common law which may result in an entity classified as ‘transparent’ in one jurisdiction but ‘non-transparent’ in another jurisdiction. The divergence in approach among jurisdictions in classifying hybrid entities can result in a conflict in the classification in a cross-border scenario. (Taneja, 2006:7).

Hybrid entity classification can have a bearing on the following:

- Determining the taxpayer – whether the entity or its members;
- Application of provisions in the income tax legislation of that jurisdiction which could be entity specific;
- Determination of residency of the entity;
- Eligibility of the entity or its members for tax treaty benefits;
- Nature of income derived by entity/members and taxation thereof;
- Double taxation issues on account of mismatch in classification;
- Tax-arbitrage opportunities and other unintended consequences. (Taneja, 2006:7).

3.2.2 Residence issues

The implications of a residence issue will be discussed in the following example.

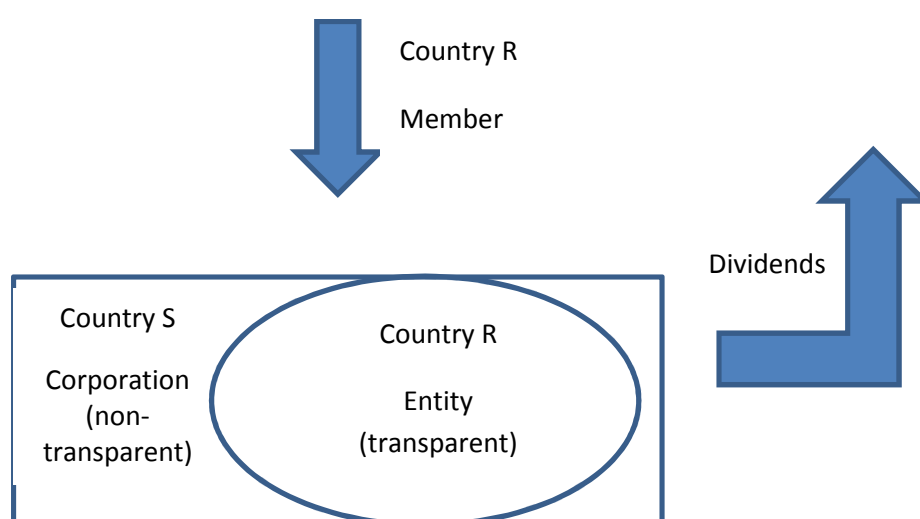


Diagram 1: Illustration of residence issues (Taneja, 2006:8)

An entity (Country S Corporation), was incorporated in a separate jurisdiction - Country S, from its shareholders/members who are residents of another jurisdiction - Country R. Country S treats Country S Corporation as non-transparent and is therefore subject to income tax in its own capacity in Country S.

Country R on the other hand treats Country S Corporation as transparent (Country R Entity) and taxes the income from Country R Entity in the hands of the shareholders/members in Country R as it has a residence based tax system. Residence based tax system in simple terms means that residents of Country R are taxed on their worldwide income and it is not limited to source income.

Country S Corporation distributes a dividend to its shareholders/members, this dividend is subject to dividend withholding tax in Country S.

The questions that arise are whether Country R shareholders/members can avail themselves of benefits of the tax treaty between Country R and Country S? As the Country R Entity is not liable for tax in Country R, it may not qualify as 'resident' even though dividend is fully taxed in Country R.

Can Country R restrict tax credit to the amount taxable in Country S? (Taneja, 2006:8).

3.2.3 Double taxation

The implications of a double taxation issue will be discussed using the facts discussed in the example above except that the distribution of profits from Country S Corporation to its shareholders in Country R occurs in year 2 and not the same year that the profits were generated in Country S Corporation.

Country S Corporation is treated as non-transparent by Country S whereas the 'same entity' referred to 'Country R Entity' is treated as transparent by Country R. Country S taxes Country S Corporation in Year 1 on business profits as well as in Year 2 on distribution (as dividend withholding tax).

On the other hand, since Country R regards Country R Entity as a Permanent Establishment ('PE') of the member in Country R, it also taxes the business profits in

Year 1. Double taxation arises from conflict in income allocation between the Country S Corporation and the PE of the members in Country R in Year 1. (Taneja, 2006:10).

3.2.4 Double non-taxation

The implications of a double non-taxation issue will be discussed in the following example.

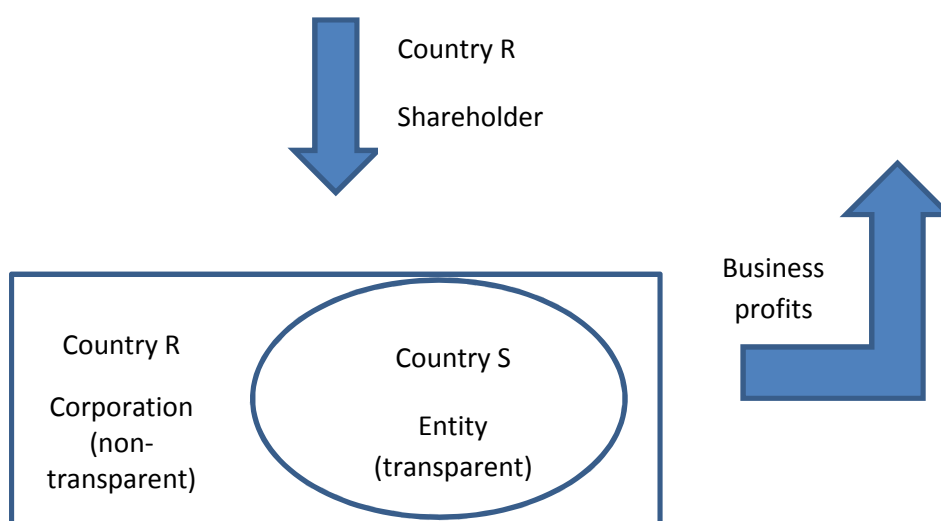


Diagram 2: Illustration of double non-taxation (Taneja, 2006:9)

An entity (Country S Entity), operates in a separate jurisdiction - Country S, from its members/ shareholders who are residents of another jurisdiction - Country R. Country S treats Country S Entity as transparent. Country S does not tax the profits as income is attributed to Country R member.

Country R on the other hand treats Country S Entity as non-transparent (Country R Corporation) and does not tax profits as it is attributable to Country S Corporation. Double non-taxation arises from conflict in income allocation between the members in Country R Entity and Country S Entity. (Taneja, 2006:9).

3.2.5 Unintended treaty benefits

In the tax treaty context, however, unwarranted tax advantages (or disadvantages) may arise if the entity is a hybrid entity. (Miller and Zhang, 2010). These advantages or disadvantages will be elaborated on in Chapter 4 that deals with the OECD Convention.

3.2.6 The possibility of avoiding the ‘Controlled Foreign Company’ Legislation

If one country classifies an entity as a partnership for tax purposes (with the result that the members or partners are taxable on their share of the entity’s income) and another country classifies the entity as a legal person or corporation (with the result that the entity itself is subject to tax on its income), the different treatment of the entity in the two countries creates many tax-planning opportunities. Taxes can be avoided by exploiting the differences between the tax treatment of taxpayers or transactions in the two countries. When an entity is classified as a corporation, the taxation of income may be deferred if the company does not distribute dividends to its shareholders. The deferral of taxes can be curbed when a country has controlled foreign company (CFC) legislation. Where the foreign entity is classified as a partnership, CFC legislation may not be applied to the entity if it is not classified as a company. Instead, the partners are taxed on their share of the profits of the partnership. The different tax treatment of the entities in the relevant countries can then be manipulated to avoid taxes. (Oguttu, 2009:59).

3.3 Conclusion

The purpose of this chapter was to address the second sub-problem of this research study which was to discuss the issues arising from the use of hybrid entities. This covers a range of issues including the classification of hybrid entities, challenges of taxing hybrid entities, tax arbitrage opportunities, unintended tax consequences of double non-taxation or double taxation, determination of residency and eligibility for tax treaty benefits.

In order to curb the issues discussed in this chapter, there are various approaches available for classification and taxation of hybrid entities, these will be discussed in the next two chapters.

4 INTERNATIONAL APPROACHES TO TAXING HYBRID ENTITIES AS RECOMMENDED BY THE OECD

4.1 Introduction

The chapter will examine the international approaches to the classification and taxation of hybrid entities as recommended by the OECD. The focus will be on the publications issued by the OECD with regard to tax policy and compliance issues, namely the report ‘Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues’ (2012) and the report ‘Addressing Base Erosion and Profit Shifting’ (2013). This chapter will highlight the significance of hybrid mismatch in the OECD project.

4.2 The reports published by the OECD

4.2.1 The partnerships report

The initial discussions of hybrid entities by the OECD were in 1999 when the OECD released a report entitled ‘The Application of the OECD Model Convention to Partnerships’ (‘partnerships report’). Briefly, the partnerships report addressed the following issues to the extent that it is relevant to this research:

- Difficulties raised by ‘conflicts in classification’ when source state and residence state apply different articles of the tax treaty;
- Potential for double non-taxation arising from conflict in classifications;
- Difficulties related to foreign tax credits that can arise from the different treatment of partnerships. (Taneja, 2006:15).

Some of the conclusions reached in the partnership report are summarized below, to the extent that they are relevant to the hybrid discussion in this research:

- where a partnership is treated as fiscally transparent in a state, it cannot be a resident of that state for purposes of the Convention;
- in determining whether a partnerships is fiscally transparent, the question is whether the amount of tax payable on the partnership income is determined in relation to the personal characteristics of the partners;

- the source state, in applying a Convention where partnerships are involved, should take into account the way in which an item of income is treated in the state of residence of the taxpayer claiming the benefit of the Convention (i.e., broadly, the state of source should take into account whether the state of residence treats the partnership as transparent or non-transparent). (Baker, 2002:5).

The partnership report recognised that degrees of transparency existed but left this issue for a follow-up report.

4.2.2 The hybrid mismatch report

In the OECD report entitled ‘Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues’ (‘hybrid report’), the OECD defines hybrid mismatch arrangements to be arrangements exploiting differences in the tax treatment of transactions, instruments, entities or transfers between two or more countries (OECD, 2012:5).

In the hybrid report, the OECD has discussed issues arising from hybrid mismatch arrangements or international arbitrage strategies. It describes the main elements of hybrid mismatch arrangement to include hybrid entities (that is, entities that are treated as transparent for tax purposes in one country and as non-transparent in another country), dual residence entities (that is, entities that are resident in two different countries for tax purposes), hybrid instruments (that is, instruments which are treated differently for tax purposes in the countries involved and the most prominently as debt in one country and as equity in another country) and hybrid transfers (that is, arrangements that are treated as transfer of ownership of an asset for one country’s tax purposes but not for tax purposes of another country, which generally sees a collateralized loan). (OECD, 2012:7).

The concerns raised by the OECD in regards to the above arbitrage strategies include double deduction schemes, deduction or no inclusion of income schemes and the artificial generation of tax credits. (OECD, 2012:7).

The hybrid report focused on four policy responses for countries concerned with hybrid mismatches, these include:

- Harmonisation of domestic laws – having one theoretical approach to eliminate differences in tax treatment of entities. This option was mentioned for completeness but is not practical to implement.

- General anti-avoidance rules including ‘abuse of law’, ‘economic substance’, ‘fiscal nullity’, ‘business purpose’ or ‘step transactions’ implemented to address some hybrid mismatch arrangements. The OECD has commented that the general anti-avoidance rules are effective but may not always provide a comprehensive response to cases of unintended double non-taxation through use of hybrid mismatch arrangements.
- Specific anti-avoidance rules – include rules denying the deduction of payments in cases where the same are subject to minimum level of taxation in the country of the recipient,
- Specific and targeted rules – rules specifically addressing hybrid mismatch arrangements as these take into account the treatment in both the domestic and foreign jurisdiction. The linkage of domestic tax treatment of a hybrid entity to the tax treatment in the foreign jurisdiction may reduce the possibility of hybrid mismatch but makes the application of the domestic law more complicated. (OECD, 2012:13-14).

The OECD concludes the hybrid report with the following recommendation:

- Countries to consider introducing or revising specific targeted rules denying hybrid benefits;
- Sharing of information and intelligence by tax authorities;
- Introducing hybrid mismatch tax disclosures to tax authorities.

4.3 Conclusion

The purpose of this chapter was to address the third sub-problem of this research study which was to examine the international approaches to taxing hybrid entities as recommended by the OECD. These approaches have been discussed by the OECD as part of the tax policy and compliance issues.

It has been established that the OECD recommends four main approaches to curbing issues arising from the use of hybrid entities. It promotes the linking approach where the domestic tax treatment follows the tax treatment of the foreign jurisdiction. The OECD has also recommended that countries including non-member states to consider introducing or revising specific targeted rules addressing issues arising from hybrid entities.

5 INTERNATIONAL APPROACHES TO TAXING HYBRID ENTITIES AS ADOPTED BY SELECTED JURISDICTIONS

5.1 Introduction

This chapter will examine the approaches to classification and taxing of hybrid entities as adopted by selected jurisdictions including the United States of America, the United Kingdom, Canada, Germany, the Netherlands and Denmark.

Not all jurisdictions follow the approach of linking the other jurisdiction entity's form into the closest domestic law equivalent, various countries have adopted various approaches.

The selected countries have introduced tax legislation dealing with hybrid entities. The approaches adopted by the selected countries will be discussed in this chapter to illustrate the various approaches available to tackle hybrid entities. These countries have either had this tax legislation in place for a few years and or have implemented similar tax legislation as the foreign partnership tax legislation introduced in South Africa which follows the tax treatment of the country of residence of the hybrid entity.

This chapter will also cover anomalies or uncertainties experienced in applying the tax legislation and discuss the recent case law dealing with hybrid entities in the United Kingdom. This discussion will seek to provide guidance to some of the existing uncertainties in applying the tax provisions dealing with hybrid entities in South Africa.

5.2 Classification and tax treatment of foreign hybrid entities in the selected jurisdictions

The approaches of classification and taxation of foreign hybrid entities vary in the various jurisdictions. A jurisdiction could use one or more of the following:

- Categorise all foreign entities regardless of the business form as corporations;
- Categorise a foreign entity according to its legal form;

- Allow the taxpayer to choose the category;
- Try to fit the entity into the closest categories of entity known in the domestic law which could sometime raise difficulty of how to determine how similar a foreign entity is to that jurisdiction's partnerships as these vary. (Jones et al, 2002:305).

5.2.1 United States of America

Generally, the foreign tax treatment of an entity is not relevant to the United States of America's taxation of that entity and its owners. If an entity is characterised as a partnership under the United States of America's tax law, the partners are considered the taxpayers for tax purposes in the United States of America, even if the entity is characterised as a corporation under the tax laws of its country of residence. (Miller and Zhang, 2010).

The United States of America has a broad discretion to determine classification of foreign entities which includes:

- a predetermined list of *per se* corporations that are always treated as corporations;
- an election for classification through the check-the-box regulations; or
- by application of default rules where a foreign entity is treated:
 - as a partnership if it has two or more members, at least one of whom does not have limited liability;
 - as an association if all the members have limited liability; or
 - as transparent if it has a single owner who does not have limited liability.

(Jones et al, 2002:306 and Taneja, 2006:13).

In terms of the United States of America's Regulation section 301.7701-2(a) and 301.7701-3 certain domestic and foreign business entities are characterised by default as disregarded entities (if they have only one owner) or partnerships (if they have more than one owner) for federal tax purposes in the United States of America, but can elect to be taxable as corporations under Regulation section 301.7701-2(b)(2). Certain foreign business entities with respect to which all the owners have limited liability are characterised by default as corporations, but can elect to be characterised as disregarded entities or partnerships (depending on whether they have more than one owner). (Miller and Zhang, 2010).

Curbing of abusive tax treaty structures

The Taxpayer Relief Act 1997 added Code section 894(c) and (d) to provide rules for determining tax treaty eligibility for hybrid and reverse hybrid entities to the Internal Revenue Code to combat abuses of tax treaty benefits, for example, the use hybrid entities to secure tax treaty benefits that clearly seemed inappropriate as a matter of policy. A reverse hybrid is an entity that is treated as fiscally transparent for foreign tax purposes and as a taxable entity in the United States of America. Pursuant to Code section 894(c)(1), tax treaty benefits are denied to a foreign person with respect to an item of income derived through a partnership (or other fiscally transparent entity), if the item is not treated by the foreign country as an item of income of such person, the tax treaty does not address the treatment of income derived through partnerships, and the foreign country does not tax the distribution of the income from the partnership to the foreign person. (Miller and Zhang, 2010).

Article 4(1)(d) of 1996 United States of America Model Tax Treaty addresses issues presented by hybrid entities 'look through' approach recognized for determining tax treaty eligibility. An item of income derived through hybrid entities will be considered as derived by a resident if the resident is treated as deriving the item of income. (Taneja, 2006:14).

United States of America arbitrage rules

The United States of America has introduced rules that specifically address mismatch arrangements, these include rules addressing the multiple deduction of the same expense and rules addressing abusive foreign tax credits transactions. (OECD, 2012:15).

To curb the multiple deductions of the same expense, the Internal Revenue Service ('IRS') and the United States of America Treasury Department issued temporary regulations under section 1503(d) of the Internal Revenue Code ('IRC') in 1989, and final regulations in 1992. In response to subsequent developments, in particular various issues or concerns involving the interaction with the entity classification rules, the IRS and Treasury Department issued new final regulations under IRC section 1503(d) in 2007 dealing with 'Dual Consolidated Loss Regulations' ('DCL Regulations'). These rules ensure that dual resident corporations are prevented from using a single economic loss once to offset income that was subject to United States of America tax, but not

foreign tax, and a second time to offset income subject to foreign tax, but not United States of America tax. In general, a dual consolidated loss is the net operating loss of a dual resident corporation, or the net loss attributable to a ‘separate unit’ (foreign permanent establishment) of a domestic corporation. A dual resident corporation is generally defined as a domestic corporation subject to the income tax of a foreign country on its worldwide income or on a residence basis. (OECD, 2012:17). This is effectively ring fencing of foreign losses.

To curb abusive foreign tax credit transactions, the IRS and the Treasury Department issued under section 901 of the IRC final and temporary regulations: TD 9416 relating to the amount of taxes paid for purposes of the foreign tax credit. These regulations address cases where the foreign payment is attributable to a ‘structured passive investment arrangement’, which in general terms is an arrangement to exploit differences between United States of America and foreign tax law in order to permit a person to claim a foreign tax credit for the purported foreign tax payments while also allowing the counterparty to claim a duplicative foreign tax benefit. Thus, the final regulations provide that amounts paid to a foreign taxing authority that are attributable to a structured passive investment arrangement are not treated as an amount of tax paid for purposes of the foreign tax credit. (OECD, 2012:21). This is the foreign tax credit limitations of tax anti-avoidance schemes.

Furthermore, the IRS and the Treasury Department issued under section 901(m) of the IRC provisions which address situations where foreign income taxes have been separated from the related income. These provisions suspend credits until the income related to those credits is included in taxable income of that taxpayer. In general terms these are transactions that create a difference between the United States of America tax base and the foreign tax base (due primarily to differences in the tax basis of the acquired assets), and may generate foreign tax credits without a related income inclusion for United States of America tax purposes. (OECD, 2012:21). This is a deferral mechanism of foreign tax credit until the related income is included in taxable income.

5.2.2 Canada

In deciding whether a foreign entity is transparent or non-transparent, Canada pays particular attention as to whether the entity is regarded by the other jurisdiction as a corporation, association, foundation or other legal form, although not an exclusive test. (Jones et al, 2002:306).

Canada generally compares the attributes of the foreign entity with the domestic entities and taxes the foreign entity the same way as the equivalent one in Canada. (Jones et al, 2002:306).

Curbing of abusive treaty structures

The fifth protocol of the Convention between the United States of America and Canada with respect to taxes on income and capital (the ‘Treaty’) introduced new anti-hybrid rules in Article IV(7) intended to deny Treaty benefits for amounts of income, profit or gains involving hybrid entities. The new rules generally operate to deem an amount of income, profit, or gain to not be paid to or derived by a resident of a contracting state in certain circumstances. Since the benefits of the Treaty are extended only to residents of the contracting states, the particular amount of income, profit, or gain will not have the benefit of any reduced rate of tax that would otherwise be available under the Treaty. (Severino, 2012).

Effective from 1 January 2010, as a result of the ratification of the fifth protocol of the Treaty, treaty-reduced withholding tax rates on payments by a Canadian ULC to a recipient in the United States of America, where the ULC is treated as a fiscally transparent entity for the United States of America’s tax purposes, are denied. The denial of treaty benefits on payments of dividends, interest and other payments, such as royalty payments, by ULCs to investors in the United States of America would make ULCs tax inefficient vehicles for investors in the United States of America. The Canada Revenue Agency published a series of advance income tax rulings and technical interpretations that accept the use of various repatriation strategies to avoid the application of the new anti-hybrid rule in certain situations. Canada Revenue Agency accepts these repatriation strategies only in certain circumstances. By way of example, a disregarded United States of America’s Limited Liability Company (‘LLC’) investing in an ULC can be tax inefficient, and even punitive in some situations, from a Canadian tax perspective. (Severino, 2012).

Canada arbitrage rules

Although Canada believes that abusive foreign tax credit schemes can be successfully challenged under its existing general anti-avoidance rule, the magnitude of the problem warranted greater assurance through specific legislative action. In an attempt to curb abusive foreign tax credit transactions that inappropriately exploit differences in countries' laws, in its Budget 2010, the Canadian government proposed measures that will deny claims for foreign tax credit in circumstances in which the income tax law of the jurisdiction levying the foreign income tax considers the Canadian taxpayer to own a lesser interest in the foreign special purpose entity than the Canadian taxpayer is considered to own for the purposes of Canada's tax law. (OECD, 2012:21).

5.2.3 United Kingdom

The United Kingdom generally compares the attributes of the foreign entity with the domestic entities and taxes the foreign entity the same way as the equivalent one in the United Kingdom. This is done by testing a list of attributes. (Jones et al, 2002:306).

Her Majesty Revenue and Customs ('HMRC') published a list of relevant factors for the purpose of classifying non-UK entities as transparent or non-transparent for tax purposes. These factors have no statutory force but represent HMRC's distillation of the limited guidance provided by the courts. The factors, none of which are conclusive, are in summary:

- 1) whether the entity has a legal existence separate from that of the persons that have an interest in it (in other words, whether it has legal personality);
- 2) whether members of the entity are 'entitled to profits as they arise';
- 3) whether the entity carries on business on its own behalf or via its members;
- 4) whether the entity issues share capital or something similar;
- 5) whether business assets belong beneficially to the entity or to its members; and
- 6) whether the entity or its members are responsible for the debts of the business.

HMRC attaches particular importance to (2) and (3). (McGowan, Thomson and Hardwick (2013). HMRC have a list of foreign entities which they have considered to be transparent or non-transparent, which includes a United States of America's LLC as non-transparent – however they are at pains to point out that for any particular entity the

classification will depend on the specific facts including the details of its constitutional documents. (Ramsay, 2010).

Two recent cases have considered the availability of double taxation relief in the United Kingdom in circumstances involving the United States of America's hybrid entities. In the *Swift UK v HMRC* case, the Tribunal considered whether a United States of America's LLC was a non-transparent or transparent entity for the United Kingdom's tax purposes and therefore whether a United Kingdom resident member of the LLC could obtain double tax relief for tax paid in the United States of America on his share of the profits. The Tribunal held, contradicting HMRC's established practice, that the LLC was transparent for the United Kingdom's tax purposes as it is more akin to a partnership than a company. This will be a concern, to the United Kingdom taxpayers with direct or indirect interests in LLCs. (Ramsay, 2010).

In the *Bayfine UK v HMRC* case, a claim was successfully made to credit the United States of America's taxes against a United Kingdom company's tax liability where such taxes arose on the same income in the company's parent in the United States of America as a result of the United Kingdom company being treated as transparent for tax purposes in the United States of America following a check-the-box election. The case looked at the analysis of the United State of America's tax treaty and unilateral tax relief under United Kingdom law for a circumstance which had not been envisaged by the treaty or United Kingdom legislation.

United Kingdom arbitrage rules

Similarly to many jurisdictions, the United Kingdom introduced anti-abuse rules to target tax arbitrage arising from hybrid entities. The legislation applies to two types of situation, known as 'deductions cases' and 'receipts cases'. The deductions cases are likely to be more commonly encountered in practice. These are where the tax advantage derives either from two deductions given in respect of the same expense or where a deduction is given but there is no corresponding pick-up of the receipt elsewhere within the structure.

The rules apply to cross-border tax planning structures that include hybrid entities. While the legislation also seeks to counteract schemes involving hybrid instruments, it

is hybrid entities that are primarily utilised in cross-border tax planning and are the subject of these rules. The legislation only applies to counteract United Kingdom tax advantages if all of the following four factors apply:

- 1) The structuring scheme involves a hybrid entity (or hybrid instrument).
- 2) The result of the structuring scheme is that a double deduction is obtained for an expense; or a single deduction is obtained but is not matched by a taxable receipt.
- 3) At least one of the main purposes of the structuring scheme is to obtain a United Kingdom tax advantage.
- 4) The United Kingdom tax advantage arising from the scheme.

The legislation applies to United Kingdom companies or branches. It does not operate on a self-assessment basis, but rather by HMRC issuing a notice. (McDermott Will & Emery, 2005).

5.2.4 Germany

The classification of a foreign entity for German tax purposes as a partnership or corporation is exclusively governed by German tax law and is based on a comparison of the main features of the foreign entity with the features of a comparable German entity (similar to the guidance regarding the German tax treatment of United States of America's LLCs). (Deloitte, 2010). The classification of a foreign entity under the foreign tax laws is irrelevant for German tax purposes, for example the fact that the members of an LLC have exercised their election in the United States of America with regard to the LLC's tax treatment is irrelevant for German tax purposes (KPMG, 2010).

For German tax purposes, a foreign entity may be classifiable either as an independent taxable entity (entity subject to corporate income taxation) or as a partnership and, where applicable, as the legally non-discrete branch (permanent establishment) of the foreign entity's sole member. The classification has relevance in particular for the taxation of the profit shares, profit distributions, and advance remuneration of members with resident tax status in the domestic territory and with regard to the entitlement to tax treaty benefits of a foreign entity that derives domestic-source income within the meaning of section 49 of the Income Tax Act in Germany. (KPMG, 2010).

The Ministries of Finance of the German States issued a decree, dated 19 March 2004, containing the following criteria to be considered for the tax classification of foreign entities:

- 1) Centralization of management - One characteristic of a corporation is centralized management and representation. It is present where one or more persons, but not all members, have exclusive ongoing authority to make the decisions necessary for carrying out the company's business purpose without the approval of all (or the remaining) members. This is the case where the company's management and its representation in outside dealings are vested in third parties or in an independent body (board of managers), to which both members and non-members may belong. (KPMG, 2010).

By contrast, there is no centralized management where the members manage the company's business themselves and have the sole right to represent it in outside dealings. (KPMG, 2010).

- 2) Limited liability - The limited liability that is typical of a corporate entity is present where none of the members are personally liable for the company's debts or for claims against the company. (KPMG, 2010).
- 3) Free transferability of interest - The free transferability of interests in the company to non-members is a material characteristic of a corporate entity. By contrast, interests in partnerships are as a rule not transferrable or transferrable only subject to limitations or only with the consent of the other partners. Free transferability of interests exists where, under applicable law or the operating agreement, the economic and membership rights conferred by the membership interest may be transferred to third parties without the consent of the other members, such that the transferee succeeds fully to all of the transferor's membership rights. Conversely, free transferability does not exist where transfer is contingent on the consent of all members or certain members. (KPMG, 2010).
- 4) Discretion to access profits - In a corporate entity, the allotment of a share of profits to a shareholder is determined by a shareholder resolution that is adopted once annually. In the case of partnerships, no distribution resolution is generally required

in order for the partner to dispose of its share of the partnership profits. (KPMG, 2010).

- 5) Equity contribution - The shareholders of a corporate entity are required to provide the company with capital in the form of contributions. By contrast, there is no statutory requirement that a partnership must be provided with equity capital. If the operating agreement dispenses with capital contributions or permits these to take the form of services, this is indicative of a partnership. (KPMG, 2010).
- 6) Continuity of life - A material characteristic of a corporate entity is its principle perpetual duration, i.e. duration independent of the composition of its shareholders. (KPMG, 2010).
- 7) Profit distribution - For corporate entities, a shareholder's profit share is determined by the par values of the stock or by the ownership interests. For partnerships, distribution is as a rule proportionate to contributions and otherwise per capita. The ability to distribute a portion of profits without regard to contributions takes account of the personal efforts of a partner in a partnership, whereas for corporate entities the shareholder's role as a provider of capital is of primary importance. (KPMG, 2010).
- 8) Formal requirements for organisations - Entry in the Commercial Register is a condition precedent to the existence of German stock corporations, partnerships limited by shares, and limited liability companies. Entry takes place only after verification that organisation and registration are in order. Consequently, in order to form a corporate entity, a public body must confirm the acceptability of its articles. It is thus not enough merely to enter into a shareholder agreement. By contrast, commercial partnerships come into existence upon the conclusion of the partnership agreement. Entry in the Commercial Register is relevant only with respect to validity with regard to third parties. (KPMG, 2010).
- 9) Other criteria - The foreign entity's legal capacity or lack thereof in the foreign jurisdiction plays no decisive role for classification purposes in addition to the characteristics mentioned. Similarly, the number of members is also not a suitable criterion for distinguishing between corporate entities and partnerships. (KPMG, 2010).

A case-by-case basis for the classification of the foreign entity as company or partnership is required. An overall assessment of whether the characteristics more closely resemble those of a typical corporation or those of a partnership. (Taneja, 2006: 16). Each of the criteria listed above must be viewed on its particular relevance and no single criterion is controlling. If such judgment on the basis of all the facts and circumstances does not readily yield a conclusion, then the LLC is classified as a corporation if the majority of the criteria under clauses (1) to (5) above indicate corporate characteristics. (Schmidt, 2008).

German arbitrage rules

Germany has introduced rules that specifically address mismatch arrangements, these include rules addressing the multiple deduction of the same expense and non-inclusion of income which is deductible at the level of the payer. (OECD, 2012:15).

To curb multiple deduction of the same expense, section 14.1.5 of the Corporation Tax Act in Germany prevents dual-resident companies from deducting the same loss in both Germany and another country. A parent company's negative income is not taken into account for purposes of the group taxation regime if the negative income is also taken into account in a foreign country in a manner corresponding with the taxation applied to the parent company under the German system. (OECD, 2012:15).

Profit distributions are generally tax-exempt for the recipient company. In order to curb the non-inclusion of income which is deductible at the level of the payer, section 8b(1) of the Corporation Tax Act in Germany denies the tax exemption for constructive dividends (*verdeckte Gewinnausschüttungen*) if such dividends were deductible expenses for the paying company. (OECD, 2012:19).

5.2.5 Netherlands

The Netherlands, like many other jurisdictions, uses its own criteria to determine if foreign hybrid entities must be considered taxable entities in which case they are seen as 'participations' which qualify for the participation exemption, or as transparent entities in which case they should be seen as a foreign branch office of the Netherlands participant/limited partner, subject to the Netherlands foreign branch income

exemption. It should be noted that the two Netherlands tax exemptions, one for income from and capital gains realised with participations and the other one for branch income, differ markedly from each other so changing the one exemption for the other may make considerable financial difference. The foreign tax criteria (like the question ‘is the hybrid entity subject to tax itself under foreign tax law?’) play no role in the Netherlands entity tax classification process either. (Peters, 2010:1).

The Netherlands Ministry of Finance offers taxpayers guidance in the ‘Netherlands tax classification of foreign entities’ process via a so-called resolution, dated 18 December 2004, which contains the following criteria (also referred to as the four-factor test):

- 1) Can the foreign entity, under its own legal system, own the assets with which the hybrid entity is conducted?
- 2) Is there at least one participant in the foreign entity who is liable for the debts of the hybrid entity without limitation?
- 3) Does the foreign entity have a capital dividend into shares? Is it a distribution of dividends or is it share of profits by the members of the foreign entity.
- 4) Can new participants access the foreign entity or can a participant transfer their share in the foreign entity to other participants without the unanimous acceptance by all participants? (Peters, 2010:1 and Taneja, 2006:17).

The answers to the above four questions will basically determine whether, from a Netherlands corporate income tax viewpoint, the foreign entity qualifies as a corporate tax entity or as a tax partnership. In case the foreign entity is legally comparable to a Netherlands ‘Commanditaire Vennootschap’ (‘CV’) (equivalent to a Netherlands LLP, it has at least one general partner and one limited partner) which is the case if questions 1 and 2 above have been answered affirmatively, the foreign entity is a ‘CV lookalike’ in which case criterion 3 loses its significance and criterion 4 needs to be looked at in detail, in which case a set of additional Netherlands rules apply, as follows:

- a) the foreign entity conducts an enterprise in its own name;
- b) there is at least one general partner and one limited partner;

- c) the general partners are liable for the debts of the foreign entity without limitation (although they might be foreign entity's themselves);
- d) the limited partner is only liable up to the amount of his capital contribution;
- e) the limited partner does not act towards third parties as representing the joint venture.

These Netherlands criteria are not part of any foreign entity tax classification rules, so a mismatch between the Netherlands and the foreign tax classification can easily result in a foreign hybrid entity. (Peters, 2010:1).

A good example of this would be the German KG: This entity very much resembles a Netherlands CV (the words even mean the same in the two languages), so from a Netherlands corporate income tax viewpoint, German KG structures where a German limited liability company acts as the general partner ('GmbH & Co KG' structures) are 'CV lookalikes'. It will then depend on the internal rules in the KG as concerns the access of new partners and the transfer of partnership shares between partners, whether the German KG is seen as a tax entity ('Open KG' from a Netherlands tax viewpoint) or as a tax transparent entity ('Closed KG'). (Peters, 2010:2).

Under German law a KG is always tax transparent. The Netherlands distinction between Open CV's and Closed CV's, is used to distinguish foreign entity interests in 'foreign participations' and 'foreign branch offices', based on the domestic foreign entity rules concerning their accessibility to new partners and to the transferability of partnership interests between partners, is a rather unpractical one. Obtaining consent from all other participants for each and every change in the partnership composition is in fact unworkable in partnerships with more than just a few partners. This, however implies that the foreign entity which resemble their Netherlands CV counterparts will usually be regarded as an 'Open KG' in which case they are treated as 'participations' of the Netherlands limited partner who participates in such a foreign entity even though abroad they are treated as tax transparent. A mismatch between the Netherlands and the foreign tax treatment of the foreign entity is therefore often unavoidable. (Peters, 2010: 2).

The Dutch Ministry of Finance published an updated annex (Annex) to the decree on

the qualification of foreign entities dated 21 December 2009 (Decree). The Decree provides for criteria that taxpayers have to apply for purposes of determining whether entities qualify as non-transparent or transparent from a Dutch corporate tax perspective. The Annex lists what the Ministry of Finance has qualified as non-transparent or transparent for tax purposes in the Netherlands. Taxpayers should take into account, however, that as under the previous annex, the qualifications as set out in this Annex merely serve as an indication for the possible classification of the foreign entity. Therefore, every entity has to be analysed on a case-by-case basis. (Taxand's Take, 2010).

Under Dutch tax law a foreign entity can qualify as non-transparent or transparent. This distinction is relevant for the tax treatment of the Dutch resident taxpayer that holds an interest in a foreign entity. For purposes of qualifying foreign entities as non-transparent or transparent, the Decree distinguishes corporations from partnerships. Corporations always qualify as non-transparent while partnerships are, in principle, treated as tax transparent unless their shares are freely transferable. The qualification of the foreign entity from a foreign tax perspective is not relevant for the Dutch analysis. Furthermore, the qualification rules do not apply to foreign entities that are comparable to an association, foundation, mutual fund, trust, special fund or cooperative entity. Separate guidance is utilised for these entities. (Taxand's Take, 2010).

5.2.6 Denmark

In deciding whether a foreign entity is transparent or non-transparent for Danish tax purposes, Denmark considers whether the entity is regarded by the other jurisdiction as a corporation or a transparent entity. Section 2A of the Corporate Tax Act in Denmark provides that a foreign entity will be deemed to be transparent for Danish tax purposes if the hybrid entity is transparent according to the tax law in the country where the foreign entity is resident. (Wittendorf, 2013).

Fibbe refers to this method as the corporation resemblance-based method. The criteria used in the corporation resemblance-based method, is largely based on civil law characteristics of the domestic entities liable to tax under domestic law. Based on the corporate law characteristics, it is determined that the foreign entity resemble local entity liable for corporate income tax. (Fibbe, 2009:154).

The Danish National Assessment Council has in previous rulings deemed foreign entities transparent for Danish tax purposes in cases where the foreign entity is categorised as a partnership. (Bjornholm and Hansen (2005).

Denmark arbitrage rules

Denmark has introduced rules that specifically address mismatch arrangements. These include rules addressing the multiple deduction of the same expense, deduction of payments which are not included in taxable income of the recipient and non-inclusion of income which is deductible at the level of the payer of the expense. (OECD, 2012:15).

To curb multiple deduction of the same expense, section 5G of the Tax Assessment Act in Denmark provides that a Danish resident taxpayer is not entitled to claim a deduction for an expense if (i) that expense is claimable under foreign tax rules against income that is not included in the computation of Danish tax, or (ii) if under the foreign tax rules, the expense is deductible against income derived by affiliated companies which is not included in the computation of Danish tax. (OECD, 2012:15).

To curb the deduction of payments which are not included in taxable income of the recipient, section 2A to the Danish Corporate Tax Act provides that a foreign entity is treated as transparent for purposes of the Danish tax law if (i) the foreign entity is treated as transparent for tax purposes in a foreign country, (ii) the income of the foreign entity is included in the foreign taxable income of one or more affiliated companies in the foreign country that treats the foreign entity as transparent; (iii) the foreign affiliated companies control the foreign entity, and (iv) the foreign jurisdiction is an European Union country, or has concluded a tax treaty with Denmark. In these circumstances, the foreign entity will not be entitled to a deduction for payments made to the parent company since the payments are considered to be within the same legal entity. (OECD, 2012:17).

To curb non-inclusion of income which is deductible at the level of the payer of the expenditure, Denmark has also introduced domestic legislation, section 2B to the Danish Corporate Tax Act to deal with cases of deduction/no inclusion through the use of hybrid financial instruments. (OECD, 2012:18).

5.3 Conclusion

The purpose of this chapter was to address the fourth sub-problem of this research study which was to examine the approaches to taxing hybrid entities as adopted by selected jurisdictions such as the United States of America, Canada, the United Kingdom, Germany, the Netherlands and Denmark.

It is clear that jurisdictions do not normally take any foreign legal aspects into account when establishing their tax classification of foreign entities: they invariably use their own criteria. These criteria manifestly differ per country. There are no signs that countries are planning, or even willing, to align their entity tax classification rules with one another, any time soon (Peters, 2010).

It has been established that in addition to the classification rules, most jurisdictions have anti-abuse rules addressing issues arising from hybrid entities either incorporated into the tax legislation or separate regulations applied by the relevant tax authorities. These rules take the form of either general anti-avoidance rules or specific anti-avoidance rules.

Now that the concept of hybrid entities has been established and the various international approaches examined, the next step is to determine how the South African approach compares with the international approaches, if at all.

6 TAXATION OF HYBRID ENTITIES FROM A SOUTH AFRICAN PERSPECTIVE

6.1 Introduction

The previous chapters have focused on hybrid entities from a general international tax perspective. This chapter will focus on the South African tax treatment of hybrid entities. It will begin with the background for the adoption of the new treatment, it will cover the new definition of foreign partnership and the amendments to various other sections in the Act such as ‘company’ and ‘person’ definitions in section 1 and section 24H(1) and (5)(a) of the Act.

The tax consequences of applying the foreign partnership definition will be highlighted. This will also cover the South African tax treatment as prescribed in section 24H that needs to be adopted by the South African shareholder/ partner/ member for the hybrid entities discussed in Chapter 2 above. The South African approach will be compared to the approaches discussed in Chapters 4 and 5 of this research report.

The introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes. With this statement in mind, this chapter will also discuss the following:

- how the foreign partnership actually operates, the implications and challenges experienced in applying the foreign partnership legislation as no guidelines were provided in conjunction with the introduction of the foreign partnership provisions, specifically with regard to the transitional arrangements for pre-existing entities;
- whether or not South Africa should introduce anti-abuse rules that other jurisdictions apply; and
- how South Africa can assist its residents to remain internationally competitive.

6.2 Introduction of the new foreign partnership definition

Prior to 24 August 2010 South Africa did not have tax legislation that dealt with hybrid entities. It was arguable whether a foreign hybrid entity such as the LLC and LLP discussed in Chapter 2 above, could be regarded as a company for South African tax purposes. Following a request by taxpayers for clarity on the tax treatment of these entities for South African tax purposes, because of their growing use by South Africans investing offshore, the foreign partnership definition was introduced into the South African income tax legislation. This definition seeks to provide certainty on the tax treatment of foreign hybrid entities and assist in curbing some forms of cross-border entity arbitrage that often result from different treatment of entities under different jurisdictions. (‘Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010’:86).

The provisions that specifically cater for foreign partnerships include:

- the newly defined terms in section 1 of the Act, being ‘foreign partnership’, ‘company’ and ‘person’; and
- section 24H provisions.

6.2.1 Definition of foreign partnership in section 1 of the Act

‘foreign partnership’, in respect of any year of assessment, means any partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic if—

- (a) for the purposes of the laws relating to tax on income of the country in which that partnership, association, body of persons or entity is formed or established—*
 - (i) each member of the partnership, association, body of persons or entity is required to take into account the member’s interest in any amount received by or accrued to that partnership, association, body of persons or entity when that amount is received by or accrued to the partnership, association, body of persons or entity; and*
 - (ii) the partnership, association, body of persons or entity is not liable for or subject to any tax on income in that country; or*
- (b) where the country in which that partnership, association, body of persons or entity is formed or established does not have any applicable laws relating to tax on income—*
 - (i) any amount—*
 - (aa) that is received by or accrued to; or*
 - (bb) of expenditure that is incurred by,**the partnership, association, body of persons or entity is allocated concurrently with the receipt, accrual or incurral to the members of that partnership, association, body of persons or entity in terms of an agreement between those members; and*
 - (ii) no amount distributed to a member of a partnership, association, body of persons or entity may exceed the allocation contemplated in subparagraph (i) after taking into account any prior distributions made by the partnership, association, body of persons or entity.*

The definition of ‘foreign partnership’ was inserted by section 6 (1)(j) of Act 7 of 2010 with effect from the commencement of years of assessment commencing on or

after 1 October, 2011 in the case of any foreign partnership that is established or formed before 24 August, 2010, and with effect from the date of establishment or formation in the case of any foreign partnership that is established or formed on or after 24 August, 2010.

The background, applications and the implications of this definition will be discussed in 6.3 and 6.4 below.

6.2.2 Other amendments to the South African legislation

In order to ensure consistent tax treatment throughout the South African tax legislation, the following sections, discussed below, were amended to align and incorporate the new foreign partnership definition.

6.2.2.1 Definition of company contained in section 1 of the Act

‘company’ includes—

- (a) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or*
- (b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or*
- (c) any co-operative; or*
- (d) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or*
- (e) any—*
 - (i)*
 - (ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002)), are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or*
- (f) a close corporation,*
but does not include a foreign partnership;

The definition of ‘company’ contained in section 1 of the Act was amended to specifically state that it does not include a foreign partnership. This amendment effectively impacts beyond the definition of company as there are other definitions that refer to the company definition in section 1.

The definition of 'foreign company' contained in section 1 of the Act refers to a company as defined, this means that for a foreign entity to qualify as a foreign company for South African tax purposes, it must first meet the requirements of the definition of a company.

The definition of a foreign company in turn impacts on the definition of controlled foreign company contained in section 9D of the Act. For a foreign entity to qualify as a controlled foreign company it must also first meet the requirements of a company for South African tax purposes.

6.2.2.2 Definition of person contained in section 1 of the Act

'person' includes—

- (a) *an insolvent estate;*
 - (b) *the estate of a deceased person;*
 - (c) *any trust; and*
 - (d) *any portfolio of a collective investment scheme other than a portfolio of a collective investment scheme in property,*
- but does not include a foreign partnership;*

The definition of person was also amended to specifically exclude a foreign partnership.

The exclusion of a foreign partnership from the definitions of company and person is to effectively align the concept of a foreign partnership to the South African partnerships that do not have a distinct legal personality for tax purposes, whether in the form of a person as defined or a company as defined. This statement leads us to the discussions of the amendments to section 24H of the Act that deals with partnerships.

6.2.3 Amendments to section 24H

24H. Persons carrying on trade or business in partnership.

- 1) *For the purposes of this section, 'limited partner' means any member of a partnership en commandite, an anonymous partnership, any similar partnership or a foreign partnership, if such member's liability towards a creditor of the partnership is limited to the amount which the member has contributed or undertaken to contribute to the partnership or is in any other way limited.*
- 2) *Where any trade or business is carried on in partnership, each member of such partnership shall, notwithstanding the fact that he may be a limited partner, be deemed for the purposes of this Act to be carrying on such trade or business.*
- 3) *Notwithstanding anything to the contrary in this Act contained, the amount of any allowance or deduction which may be granted to any taxpayer under any provision of this Act in respect of or in connection with any trade or business carried on by him in a partnership in relation to which he is a limited partner shall not in the aggregate exceed the sum of—*

- (a) *the amount, whether it consists of the taxpayer's contribution to the partnership or of any other amount, for which the taxpayer is or may be held liable to any creditor of the partnership; and*
- (b) *any income received by or accrued to the taxpayer from such trade or business.*
- 4) *Any allowance or deduction which has been disallowed under the provisions of subsection (3) shall be carried forward and be deemed to be an allowance or deduction to which the taxpayer is entitled in the succeeding year of assessment.*
- 5)
 - (a) *Where any income has in common been received by or accrued to the members of any partnership or foreign partnership, a portion (determined in accordance with any agreement between such members as to the ratio in which the profits or losses of the partnership are to be shared) of such income shall, notwithstanding anything to the contrary contained in any law or the relevant agreement of partnership, be deemed to have been received by or to have accrued to each such member individually on the date upon which such income was received by or accrued to them in common.*
 - (b) *Where a portion of any income is under the provisions of paragraph (a) deemed to have been received by or to have accrued to a taxpayer, a portion (determined as aforesaid) of any deduction or allowance which may be granted under the provisions of this Act in the determination of the taxable income derived from such income shall be granted in the determination of the taxpayer's taxable income so derived*

The definition of a 'limited partner' in section 24H(1) of the Act now specifically includes a 'foreign partnership' resulting in the members of a foreign partnership to be subject to the provisions of section 24H of the Act.

6.3 Tax consequences of the new foreign partnership definition

In terms of South African law, a partnership does not have a distinct legal personality from its partners. Thus members of a partnership are liable for the debts of a partnership equally or as agreed by them. The Act follows this principle and does not treat a partnership as a legal person. Partnerships are thus excluded from the definition of a person in the Act and are thus not subject to South African tax. The partners are taxed on the income of the partnership equally (or in accordance with the terms of a partnership agreement) and likewise the expenses of the partnership are claimed by the partners. Any proceeds received from the disposal of a partnership's assets will be included in each partner's income for capital gains tax purposes. (De Koker and Williams, 2013). In line with the addition of a definition of a foreign partnership into the Act, the definition of a person in section 1 has been amended so as to exclude a foreign partnership. This means that a foreign partnership is now treated as being fiscally transparent (i.e. having no separate legal personality) for South African income tax purposes. Consequently, the income of a foreign partnership is taxed in the hands of its South African partners as is the case in respect of South African partnerships.

Furthermore, the definition of a company has been amended to exclude a foreign partnership from being regarded as a company for South African tax purposes.

A number of jurisdictions such as the United States of America, the United Kingdom, Canada, France and Germany have hybrid entities which have separate legal personality with the characteristics of a partnership as discussed in Chapter 2 above.

In the case of the United State of America this hybrid entity is known as a Limited Liability Company ('LLC'). The LLC is treated as a legal person in the US and provides its shareholders with an option of treating it as either a company or a partnership with limited liability. An LLC which has opted to be treated as a partnership is now also regarded as a foreign partnership for South African tax purposes and the partners are taxable on the profits of the partnership. ('Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010':86).

The hybrid entity in the United Kingdom is known as a Limited Liability Partnership ('LLP'). Though this entity has a separate legal personality, its income is taxable in the hands of each partner thus it is now regarded as a foreign partnership for South African tax purposes. ('Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010':86).

German legislation caters for a form of commercial partnership known as a GmbH & Co KG in terms of which the German Limited Partnership 'Kommanditgesellschaft' ('KG') forms a partnership with a limited liability company 'Gesellschaft mit beschränkter Haftung' ('GmbH'). The GmbH & Co KG is a partnership but is a variation of the usual partnership Kommanditgesellschaft (KG), as it has legal capacity to sue and be sued, (GRP Rainer Lawyers and Tax advisors) however, it is a fiscally transparent entity in Germany thus it is now regarded as a foreign partnership for South African tax.

These types of entities are now regarded as foreign partnerships for South African tax purposes with the result that their income is now taxable in the hands of any South African resident that is a member of such 'associations'.

6.3.1 Impact on South African investors in foreign companies

Prior to the amendment, the LLCs, LLPs as well as GmbH & Co KG could have been seen as being companies and not partnerships due to their legal nature for purposes of South African tax law. As a result of this, these entities were treated as controlled foreign companies ('CFCs') in terms of section 9D of the Act in instances where a South African 'shareholder' held more than 50% of the 'shareholding' in these entities. If the income of these foreign entities did not meet any of the CFC exemptions contained in section 9D of the Act, the South African 'shareholder' would then be required to attribute the foreign entity's income into its taxable income. Likewise, if the income of these foreign entities did meet any of the CFC exemptions contained in section 9D of the Act, the foreign entity's income would be exempt and will not be attributable to the South African 'shareholder'.

The new foreign partnership legislation has resulted in certain entities that were previously treated as CFCs in terms of section 9D of the Act being treated as foreign partnerships for South African tax purposes. This is due to the fact that these entities are no longer considered as companies as defined in section 1 of the Act. This means that the income of the foreign partnership is now attributed to the South African partner and the provisions and exemptions contained in the CFC rules contained in section 9D of the Act are no longer applicable to these entities as these entities are no longer regarded as CFCs in terms of section 9D.

The change in the treatment of these entities from CFCs to foreign partnerships may inadvertently result in deemed exit charges in terms of section 9H and paragraph 12 of the Eighth Schedule of the Act for the CFC that is now ceasing to be a CFC for South African tax purposes, and instead being classified as a foreign partnership.

In addition, foreign entities which are less than 50% held by one or more South African shareholders in the aggregate are excluded from the CFC provisions and their income is ignored for South African tax purposes. Nevertheless, with the new foreign partnership legislation, any shareholding or interest in a foreign partnership is now taken into account for purposes of attributing an appropriate percentage of the income of these entities' income into the South African tax net. Consequently, this increases the number of entities that need to be taken into account from a compliance perspective.

6.3.2 Impact on distribution of profits

In line with this reasoning that the LLCs, LLPs as well as GmbH & Co KG could have been seen as being companies and not partnerships due to their legal nature for purposes of South African tax law, the profits that were distributed by a foreign entity such as an LLC or LLP were treated as dividends. In instances where a South African resident held more than 20% of the 'shareholding' in these foreign entities, the South African resident would treat these profits as being exempt from South African tax in terms of the participation exemption contained in section 10(1)(k)(ii)(dd) for dividends distributed prior to 1 March 2012. Where a South African resident holds more than 10% of the 'shareholding' in these foreign entities, the South African resident treats these profits as being exempt from South African tax in terms of the participation exemption contained in section 10B of the Act for dividends distributed on or after 1 March 2012. As soon as the amendments came into effect, the foreign entities were regarded as foreign partnerships and the participation exemption was no longer available to these entities.

In addition, a new definition of the term 'foreign dividend' was added to section 1 of the Act. In terms of this definition,

'foreign dividend' means any amount that is paid or payable by a foreign company in respect of a share in that foreign company where that amount is treated as a dividend or similar payment by that foreign company for the purposes of the laws relating to—

- (a) tax on income on companies of the country in which that foreign company has its place of effective management; or*
- (b) companies of the country in which that foreign company is incorporated, formed or established, where the country in which that foreign company has its place of effective management does not have any applicable laws relating to tax on income,*

but does not include any amount so paid or payable that—

- (i) constitutes a redemption of a participatory interest in an arrangement or scheme contemplated in paragraph (e) (ii) of the definition of 'company'; or*
- (ii) is deductible by that foreign company in the determination of any tax on income on companies of the country in which that foreign company has its place of effective management;*

The new foreign dividend definition is effective from 1 January 2011.

In terms of the amended foreign dividend definition, any profit distributions made by a foreign partnership is no longer treated as a dividend. In line with the new foreign partnership legislation, partnership income is now attributed to the South African partner. As a result, any distributions made by the foreign partnership is not treated as a dividend if they are not treated as such in terms of the tax or companies laws applicable in the partnership's country of residence. Consequently, the participation exemption

contained in section 10B of the Act is no longer applicable to distributions made by the foreign partnership. In terms of the participation exemption, any dividends declared by a foreign company in which a South African company holds at least 10% of the shareholding in, is exempt from South African tax.

6.3.3 Impact on foreign tax credits

From the effective date of the foreign partnership legislation, (24 August 2010 for entities that are established or formed on or after that date otherwise 1 October 2011 for entities that were established or formed before 24 August 2010) the South African member in a foreign partnership is taxable in South Africa on its share of the foreign partnership's taxable income and not on the distributions of profits by the foreign partnership. The South African resident is allowed to claim any foreign taxes paid in the country in which the foreign partnership operates in as a rebate from South African tax in terms of the provisions of section 6quat of the Act. This rebate is limited to South African tax that is attributable to the foreign income.

Consequently two calculations are required to be made in order to determine the foreign partnership's taxable income for the foreign country's tax purposes and for South African tax purposes. The applicable rebate which is claimable in South Africa on the foreign tax paid can then be calculated. This has resulted in an increased administration burden for the foreign partnership's South African member. Furthermore, the foreign partnership is not permitted to claim a rebate on foreign taxes paid on income in terms of section 6quat (1A) if such income is not taxable in South Africa. This, and the fact that South African tax principles apply to calculate the South African tax payable, may result in a higher overall tax burden. This means that more effort is required in order to determine if any taxes paid (such as the trade taxes in Germany) by the foreign partnership can be claimed as a rebate in terms of the provisions of 6quat of the Act. Where rebates are not utilised in the current year and are carried over to the following year, appropriate records of such rebates should be kept and tracked accordingly.

6.3.4 Impact on tax losses

In terms of section 20(1)(b) the Act, losses which arise from the carrying on of a trade outside South Africa may not be set off against South African sourced income. Consequently any losses incurred outside South Africa by the foreign partnerships cannot be set off against South African income. The South African resident partner in the foreign partnership is required to offset these losses against any future foreign income which it will receive. Similarly, any losses which are not utilised in the current year are carried over to the following year. This requires that appropriate records of such losses are kept and tracked accordingly.

6.3.5 Administrative burden

The foreign partnership legislation has resulted in an increased administrative burden for the South African company or person that is a partner in the foreign partnership, as two tax calculations are prepared by the South African partner in respect of its share in the foreign partnership. One calculation (which is generally done) is undertaken for purposes of the country of residence of the partnership taking that country's tax principles into account, and another (new) calculation is performed to take the South African tax principles into account. This means that more information is obtained from each foreign partnership in order to determine the appropriate South African tax implications for all transactions of the partnership.

As the exemptions in South Africa's CFC legislation are no longer applicable, and because the foreign partnership income is attributed to the South African partner for South African tax purposes, more effort is made in order to determine if any taxes paid (such as the trade taxes in Germany) by the foreign partnership are claimable as a rebate in terms of the provisions of 6quat of the Act. Where rebates are not utilised in the current year and are carried over to the following year, appropriate records of such rebates are kept and tracked accordingly.

Any losses that may arise from the foreign partnerships can only be set-off against any foreign income received or accrued by such resident and not against the resident's South African income. Similarly, any losses which are not utilised in the current year are carried over to the following year. This requires that appropriate records of such losses are kept and tracked accordingly.

6.4 Challenges of applying the foreign partnership definition

This chapter also seeks to present the challenges experienced and anomalies created in applying the foreign partnership legislation as no guidelines were provided in conjunction with the introduction of the foreign partnership provisions, specifically with regard to the transition for pre-existing entities.

The following areas; exit charges, asset take-on balances and capital allowances of acquired assets will be discussed in this chapter. These areas include provisions that do not specifically cater for foreign partnerships which tend to create problems or anomalies for pre-existing entities that are now classified as foreign partnerships.

6.4.1 Exit charges

The first question that arises for pre-existing entities on introduction of the foreign partnership legislation, is whether or not exit charges arise in terms of section 9H (income tax) and paragraph 12 of the Eighth Schedule of the Act (capital gains tax) when a foreign entity is re-classified as a foreign partnership in terms of the new definition.

The exit charges (income tax and capital gains tax ('CGT')) that would be triggered in the case of an entity that previously qualified as a controlled foreign company ('CFC') as defined, but which has now ceased to be a CFC and is instead classified as a foreign partnership, following the introduction of the definition of the 'foreign partnership' into the Act with effect from the years of assessment commencing on or after 1 October 2011. This date applies in the case of any foreign partnership that was established or formed before 24 August 2010.

No specific provisions have been included in the Act to deal with the situation where a foreign company (whether or not it qualified in the past as a CFC) becomes a foreign partnership as defined for South African tax purposes. It is submitted that a taxpayer would have to resort to general principles contained in the Act in determining whether or not the exit charge would arise. Although the approach based on general provisions contained in the Act is reasonable and justifiable there is no guarantee that the South African Revenue Service ('SARS') would necessarily agree with them.

In terms of section 9H(3) of the Act, where a company that is a CFC ceases, otherwise than by way of becoming tax resident in South Africa, to be a CFC during any foreign tax year of that CFC, that company must be treated as having disposed of each of the company's assets on the day immediately before the day on which it ceased to be a CFC for an amount received or accrued equal to the market value of the assets concerned on that day.

Consequently, the CFC (prior to becoming a foreign partnership) would be deemed to sell its trading stock and its capital assets at their open market value and to be taxable on any revenue or capital gains that might be triggered.

To the extent that the CFC has a foreign business establishment as defined in section 9D, then an exemption from South African tax is available to prevent any deemed revenue or capital gain being imputed in the South African partner that holds direct or indirect participation rights and/or voting rights in the CFC, for South African tax purposes as a result of section 9H(3) of the Act. It is submitted that the provisions in section 9H and paragraph 12 of the Eighth Schedule of the Act that refer to a CFC ceasing to be a CFC because it is becoming South African tax resident do not apply in these circumstances. The foreign company is not regarded by SARS as continuing to exist as a South African tax resident. Rather, by categorising the company that previously qualified as a CFC as a foreign partnership, the whole existence of the foreign company for South African tax purposes is ignored - effectively the foreign company is deemed to be liquidated.

If the foreign company that is re-classified as a foreign partnership did not previously qualify as a CFC, then it is submitted that no exit tax can be triggered when the company is classified as a partnership for South African tax purposes. The foreign company was previously outside of the SA tax net, assuming that it is effectively managed outside South Africa and hence is not a South African tax resident in its own right, and SARS cannot tax any of its income directly or indirectly until such time as it qualifies as a foreign partnership with one or more South African tax resident partners.

6.4.2 Asset take-on balances

Another question is what the asset take-on balances for South African tax purposes should be for the foreign partnership's assets in the case of a foreign partnership previously treated as a CFC and a foreign partnership the income of which was not previously required to be included in the South African tax net (for example, because the foreign partnership has the legal form of a separate corporate entity in which the South African tax resident partner holds less than 50% directly or indirectly of the participation rights and voting rights).

Once again, no specific provisions have been included in the Income Tax Act to deal with the situation where a foreign company (whether or not it qualified in the past as a CFC) becomes a foreign partnership as defined for South African tax purposes. It is submitted that a taxpayer would have to resort to general principles contained in the Act in determining what the take-on balances of assets of the new foreign partnership is.

Where the foreign company (whether or not a CFC) is a connected person as defined that will now be treated as a partner in the relevant foreign partnership, it is submitted that paragraph 20(1)(h)(vi) of the Eighth Schedule of the Act should apply to allow the South African company a market value base cost for CGT purposes in respect of assets deemed acquired by it from the foreign company. It is submitted that the market value should be that of the particular assets concerned, not of replacement assets. In the case of assets that depreciate over time, this market value will be lower than the original cost to the foreign entity of the assets.

With regard to trading stock, section 22(4) of the Act provides that if trading stock has been acquired by any person for no consideration or for a consideration which is not measurable in terms of money, the taxpayer should in general for the purposes of section 22(3) of the Act be deemed to have acquired the trading stock at a cost equal to its market value on the date of acquisition. It is submitted that it would be a reasonable approach to argue that this subsection should apply where a taxpayer is deemed to have acquired trading stock for South African tax purposes even if the taxpayer factually is not the legal owner of that trading stock.

6.4.3 Capital allowances on acquired assets

Another unanswered question is which capital allowances would be available under South African tax law in respect of the foreign partnership's assets and how to calculate such allowances, again in the case of both a foreign partnership previously treated as a CFC and a foreign partnership the income of which was not previously required to be included in the South African tax net.

Once again, no specific provisions have been included in the Act to deal with the situation where a foreign company (whether or not it qualified in the past as a CFC) becomes a foreign partnership as defined for South African tax purposes. It is submitted that a taxpayer would have to resort to general principles contained in the Act in determining which capital allowances are available for the assets of the new foreign partnership. Determining the available capital allowances for the foreign partnership is not as straightforward as there is nothing in the Act which explicitly covers capital allowances in the context of an entity that is classified as a foreign partnership but which in law takes the form of a company or body corporate.

Capital allowances are in general more complicated and each allowance provision needs to be analysed independently. For example section 11(e) capital allowance provisions requires that the taxpayer own the assets or have acquired them under an agreement and also that the taxpayer use the assets for the purposes of his or her trade in the year in which the capital allowance is claimed. It is submitted that strictly, legally, these requirements are not met, assuming the assets legally continue to be owned by a foreign legal person, although it would seem very inequitable for SARS to take this point given that the assets are now regarded as attributable to a foreign partnership and consequently the partners in the partnership are deemed under section 24H(2) of the Act to be carrying on the trade or business of the partnership. Since the true owner and user of the assets has become transparent for South African tax purposes, it is submitted that the assets are now owned and used by the partnership, and consequently by the partners pro rata to their partnership interests.

Another example are sections 12B and 12C capital allowances. Both sections base the allowances on the cost to the taxpayer of the asset and provide that the allowances shall not in the aggregate exceed that cost. In the situation where a foreign company has been re-classified as a foreign partnership, the South African partner has not incurred any cost in regard to the partnership assets. It is submitted that it could be argued that the

provisions in the Eighth Schedule paragraph 20(1)(h)(vi), read together with paragraph 38 (which deems a taxpayer that acquires an asset from a connected person for a non-arm's length consideration to be acquiring it at market value, resulting in the South African taxpayer having a market value base cost in the assets for CGT purposes) can be used in support of a position that the taxpayer is deemed to have incurred a market value cost for the purpose of claiming section 12 allowances. Although this seems equitable, there is nothing in the Act explicitly supporting such an approach. Sections 12B(3) and 12C(2) of the Act contain an express provision restricting 'cost' to the actual cost to the taxpayer where this is lower than market value.

These sections also require the assets to have been brought into use for the first time by the taxpayer claiming the allowances. This does not mean, unless the relevant provision explicitly provides otherwise, that the assets had to be new or unused when acquired (or in this case, deemed to be acquired) by the taxpayer but rather that a taxpayer may not claim allowances more than once on the same asset or piece of equipment. Again, since section 24H of the Act is deeming the South African resident partner to be carrying on the business in partnership in which the relevant assets are used, it seems equitable for the taxpayer concerned to be able to claim the allowances (assuming they are otherwise applicable), starting from the first year in which the South African resident partner is regarded as carrying on the relevant business in partnership. It is submitted that the provisions of section 12B(4B) or section 12C(4A) of the Act would not apply to limit the allowances that can be claimed, since it is not the South African taxpayer that has previously used the assets in the course of its trade.

Any allowances that are granted would be subject to the ring-fencing provisions in section 24H of the Act.

6.5 The South African approach in comparison to other international approaches

The approaches of classification and taxation of foreign hybrid entities vary in the various jurisdictions, a jurisdiction could use one or more of the following:

- Categorise all foreign entities regardless of the business form as corporations;
- Categorise a foreign entity according to its legal form;

- Categorise a foreign entity according to the tax treatment of the entity based on the country to which it is resident (that is linked to fiscal treatment of entity in foreign jurisdiction);
- Allow the taxpayer to choose the category;
- Rely on tax treaty to provide for the classification;
- Try fit the entity into the closest categories of entity known in the domestic law which could sometime raise difficulty of how to determine how similar a foreign entity is to that jurisdiction's partnerships as these vary. (Jones et al, 2002:305).

Prior to the introduction of the new foreign partnership definition into the South African tax system, the South African taxpayers classified foreign entities based on their legal form. If the entity was an incorporated entity (that is a corporate) in its country of residence, then it would be treated as a company for South African tax purposes regardless of how it is treated for the tax purposes in the country in which it was incorporated resulting in a hybrid entity.

The current approach adopted in the South African tax system for the tax treatment of hybrid entities is linked to the foreign fiscal treatment; only in the absence of such tax laws does the South African tax treatment follow its legal form. In terms of this approach, the South African resident with an interest or shareholding in a hybrid entity is required to follow the tax treatment of the entity in the jurisdiction in which it is resident.

The approach adopted by South Africa follows the approach as was recommended by the OECD report on Partnerships stating that in the case of conflicts of classification (owing to differences in the domestic law between the state of source and the state of residence), the classification under the law of source state should be binding upon the residence state.

This approach appears to be based on the wording of Article 23 of the OECD Model Convention requiring that double taxation relief should be granted, either through the exemption or credit system, where an item of income may be taxed, 'in accordance with the provisions of the Convention'. Thus, the state of residence has a treaty obligation to apply the exemption or credit methods vis-à-vis any item of income where the Convention authorises taxation of that item of income by the state of source. (Oguttu, 2009:62).

The OECD partnerships report states that the meaning of the phrase ‘in accordance with the provisions of this Convention’ implies that

‘[w]here due to differences in the domestic law between the state of source and the state of residence, the former applies, with respect to a particular item of income, provisions of the Convention that are different from those that the state of residence would have applied to the same item of income, the income is still being taxed in accordance with the provisions of the Convention, in this case as interpreted by the state of source. In such a case, therefore, art 23 requires that relief from double taxation be granted by the state of residence notwithstanding the conflict of qualification resulting from these differences in domestic law’.

Oguttu (2009) stated that, Engelen and Pötgens contend that for this approach to be effective, it would require the inclusion of a specific provision to that effect in a tax treaty. The Netherlands also subscribes to this view. Its observation to the OECD Report on Partnerships in respect to this solution is that it can only be applicable to the extent that it is explicitly stated in a specific tax treaty. (Oguttu, 2009:62).

The approach adopted by the United States of America differs to the approach adopted in South Africa with regard to the tax treatment of hybrid entities. The United States of America is the only jurisdiction in the selected jurisdictions in this report that has a broad discretion for classification of hybrid entities. In addition to the classification rules, it has introduced provisions in its treaties to curb the abuse of treaties through the use of hybrid entities and has also introduced anti-abuse rules that specifically target mismatch arrangements.

The approaches adopted by Canada and Denmark are similar to the approach adopted by South Africa as these jurisdictions consider the tax treatment of the foreign entity in the foreign jurisdiction. Canada and Denmark generally compare the attributes of the foreign entity with the domestic entities and tax the foreign entity the same way as the equivalent one in the domestic law. In addition to the rules for classification of hybrid entities, Canada has introduced provisions in its treaties to curb the abuse of treaties through use of hybrid entities and recently introduced anti-abuse rules with specific focus on the foreign tax credit schemes. As part of the classification rules, Denmark has introduced anti-abuse rules specific to addressing anti-abuse through use of hybrid structures.

The tax authorities in the United Kingdom, the Netherlands and Germany have published the criteria used for categorising entities as transparent or non-transparent for tax purposes. This approach differs to the South African approach as the classification of foreign entity is determined on a case-by-case basis considering the various attributions of the foreign entity and not only the tax treatment of the resident state of

the hybrid entity. In addition to the classification of hybrid entities, these jurisdictions have introduced specific and targeted rules for anti-abuse of hybrid entities.

Not all jurisdictions follow the approach of linking the other jurisdiction entity's form into the closest domestic law equivalent as is the case in South Africa. It is clear that jurisdictions do not normally take any foreign legal aspects into account when establishing their tax classification of foreign entities: they invariably use their own criteria. These criteria manifestly differ per country. There are no signs that countries are planning, or even willing, to align their entity tax classification rules with one another, any time soon (Peters, 2010).

6.6 Anti-abuse rules

As can be ascertained above, many jurisdictions have introduced anti-abuse rules to target tax arbitrage arising from hybrid entities either through regulations or as specific provisions in the treaties. The anti-abuse provisions prevent cross-border tax arbitrage on account of mismatch in entity classification. The OECD in its report entitled 'Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues', the OECD recommends that countries introduce rules specifically addressing hybrid arrangements, these rules address multiple deduction of the same expense, deduction of payments which are not included in taxable income of the recipient, non-inclusion of income which is deduction at the level of the payer, and the abusive foreign tax credit transactions (OECD, 2012: 13 - 18).

It is appreciated that South Africa is not a member of the OECD and therefore is not obliged to consider the recommendations issued by the OECD but South Africa has an observer status. Some of these rules may have been catered for in the existing general anti-avoidance provisions throughout the Act or recent amendments to the Act relating to hybrid instruments. It may be worthwhile revisiting the Act to ensure that the general anti-avoidance provisions adequately cover all hybrid arrangements.

6.7 International competitiveness

A pure anti-deferral or avoidance regime would immediately deem back all the South African owned foreign entity income so that none of this foreign income receives any

advantage over domestic income. Like other internationally used tax regimes, it is important to cater for international competitiveness. International competitiveness dictates that foreign entity income should be ignored so that South African multinationals can fully compete on an equal basis with their international rivals. (Engel, 2002:1).

The principles of anti-deferral or avoidance and international competitiveness are diametrically opposed. Anti-deferral or avoidance warrants complete taxation, whereas international competitiveness warrants complete exemption. In the end, South Africa needs to follow international norms favouring a balanced approach. Section 9D of the Act achieves this balance by favouring international competitiveness (that is exemption) where the income stems from active operations. Anti-deferral (that is immediate taxation) applies where the income stems from passive investments or from transactions that meet objective criteria with a high tax avoidance risk. (Engel, 2002:1).

Introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes. With this statement in mind, it is submitted that it is equally important to highlight that the introduction of the foreign partnership tax legislation in South Africa should consider some the exemptions available in section 9D of the Act an exemption equivalent to the foreign business establishment and the so-called high tax exemption. Consideration of similar exemptions for hybrid entities will ensure that foreign entities with genuine commercial substance and reasons for establishing these hybrid entities are not inadvertently caught by these anti-avoidance provisions resulting in increased administrative burdens as discussed above.

6.8 Conclusion

The purpose of chapter was to address the fifth sub-problem of this research study which was to examine and compare the approach introduced into the South African tax legislation for classification and taxation of hybrid entities. This sub-problem was addressed not only through comparison of the South African approach to international approaches but also required unpacking the operation, implications and challenges of applying the new foreign partnership tax legislation from a South African tax perspective.

As the introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes, it is submitted that it was important to cover this area as well. The next chapter summarises the research findings and concludes on the research problem.

7 CONCLUSION

7.1 Introduction

This chapter summarise the research findings and provide recommendations. This chapter concludes by discussing the contribution made by this research report.

7.2 Research findings

The primary objective of the research report was to determine how the approach adopted by South Africa to classification and taxation of hybrid entities compare to international approaches as recommended by the OECD or those adopted by selected foreign jurisdictions? The objective of the problem statement was achieved by addressing the following sub-problems and the results provided below:

- 1) Analysing the concept of hybrid entities. The focus was to differentiate these entities from similar structures in certain jurisdictions and to determine why such entities are formed.

This research report has established that the hybrid entities may take on a variety of forms depending on the jurisdiction in which it was established. These entities may exist in the form of a corporation having a separate legal personality from its members or shareholders but treated as fiscally transparent through an elective approach or they may also take the form of a limited liability partnership or hybrid partnerships such as the German GmbH & Co KG which has attributes of both a corporation and a partnership that may or may not have a separate legal personality but has legal capacity and is treated as fiscally transparent.

It also established that there are various tax and non-tax reasons why these entities are established. These entities are not only established to exploit the differences in the tax treatment of entities between two or more countries. Hybrid entities generally have flexibility in operations, unlike a corporation; a hybrid entity generally does not require a distinction between the owners of the company (its

shareholders) and its managers (directors). Shareholders or members of the foreign entity have better control over management. Members of hybrid entities in most jurisdictions, benefit from the limited liability, and so their own personal assets will be protected whilst those of the hybrid will be at risk. It has the advantage of flexibility in international tax planning. It provides an element of tax protection for retained profits: these may be allocated as a profit share of the corporate member and then lent back to the trading entity. It provides for flexible exit arrangements. The partnership agreement may provide that the company member's capital entitlement on a sale is similar to that of a preference shareholder's where the company is entitled to a return of capital only. Where there is possible access to special tax reliefs, the hybrid entity can claim those reliefs.

- 2) Discussing the issues arising from the use of hybrid entities. This covered a range of issues including the classification of hybrid entities, challenges of taxing hybrid entities, tax arbitrage opportunities, unintended tax consequences of double non-taxation or double taxation, determination of residency and eligibility for treaty benefits.

Various issues were identified and discussed for the use of hybrid entities. As a result of the existence of a variety of forms of hybrid entities, it is almost inherent that issues will arise particularly in cross-border activities.

- 3) Examining the international approaches to taxing hybrid entities as recommended by the OECD. These approaches have been discussed by the OECD as part of the tax policy and compliance issues.

It has been established that the OECD recommends four main approaches to curbing issues arising from the use of hybrid entities. It promotes the linking approach where the domestic tax treatment follows the tax treatment of the foreign jurisdiction. The OECD has also recommended that countries including non-member states to consider introducing or revising specific targeted rules addressing issues arising from hybrid entities.

- 4) Examining the approaches to taxing hybrid entities as adopted by selected jurisdictions such as the United States of America, Canada the United Kingdom,

Canada, Germany, the Netherlands and Denmark. The challenges experienced and related case law was discussed with regard to the approaches adopted for some of these countries.

It is clear from the work done in this research report that jurisdictions do not normally take any foreign legal aspects into account when establishing their tax classification of foreign entities: they invariably use their own criteria. These criteria manifestly differ per country. There are no signs that countries are planning, or even willing, to align their entity tax classification rules with one another, any time soon.

It has been established that the approaches of classification and taxation of foreign hybrid entities vary in the various jurisdictions, a jurisdiction could use one or more of the following:

- Categorise all foreign entities regardless of the business form as corporations;
- Categorise a foreign entity according to its legal entity;
- Categorise a foreign entity according to the tax treatment of the entity based on the country to which it is resident (that is linked to fiscal treatment of entity in foreign jurisdiction);
- Allow the taxpayer to choose the category;
- Rely on tax treaty to provide for the classification;
- Try fit the entity into the closest categories of entity known in the domestic law which could sometime raise difficulty of how to determine how similar a foreign entity is to that jurisdiction's partnerships as these vary. (Jones et al, 2002:305).

It has also been established that in addition to the classification rules, most jurisdictions have anti-abuse rules addressing issues arising from hybrid entities either incorporated into the tax legislation or as separate regulations applied by the relevant tax authorities or even incorporated into the treaties. These rules take the form of either general anti-avoidance rules or specific anti-avoidance rules.

- 5) Examining and comparing the approach introduced into the South African tax legislation for classification and taxation of hybrid entities. As this is new legislation, part of this sub-problem was to understand how the South African approach of classification and taxation of hybrid entities actually operates, the implications and challenges of applying the new foreign partnership tax legislation. As the introduction of the new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes, it was important to determine how this balance should be achieved.

Prior to the introduction of the new foreign partnership definition into the South African tax system, South African taxpayers classified foreign entities based on their legal form. If the entity was an incorporated entity (that is a corporation) in its country of residence, then it would be treated as a company for South African tax purposes regardless of how it is treated for the tax purposes in the country in which it was incorporated resulting in a hybrid entity.

The current approach adopted in the South African tax system for the tax treatment of hybrid entities is linked to the foreign fiscal treatment of the foreign entity, only in the absence of tax laws will the legal form be considered. In terms of this approach, the South African resident with an interest or shareholding in a hybrid entity is required to follow the tax treatment of the entity in the jurisdiction in which it is resident.

The approach adopted by South Africa follows the approach as was recommended by the OECD in its report on Partnerships stating that in the case of conflicts of classification (owing to differences in the domestic law between the state of source and the state of residence), the classification under the law of source state should be binding upon the residence state.

It has also been established that for this approach, to be effective, it would require the inclusion of a specific provision to that effect in a tax treaty. South Africa's approach to classification and taxation of hybrid entities differs with some of the selected jurisdictions.

It has been established that the approach adopted by the United States of America differs to the approach adopted in South Africa with regard to the tax treatment of hybrid entities. The United States of America is the only jurisdiction in the selected jurisdictions in this report that has a broad discretion for classification of hybrid entities. In addition to the classification rules, it has introduced provisions in its treaties to curb the abusive of treaties through the use of hybrid entities and has also introduced anti-abuse rules that specifically target mismatch arrangements.

The approaches adopted by Canada and Denmark are similar to the approach adopted by South Africa as these jurisdictions consider the tax treatment of the foreign entity in the foreign jurisdiction. Canada and Denmark generally compare the attributes of the foreign entity with the domestic entities and tax the foreign entity the same way as the equivalent one in the domestic law. In addition to the rules for classification of hybrid entities, Canada has introduced provisions in its treaties to curb the abuse of treaties through use of hybrid entities and recently introduced anti-abuse rules with specific focus on foreign tax credit schemes. As part of the classification rules, Denmark has introduced anti-abuse rules specific to addressing anti-abuse through the use of hybrid structures.

The tax authorities in the United Kingdom, the Netherlands and Germany have published the criteria used for categorising entities as transparent or non-transparent for tax purposes. This approach differs to the South African approach as the classification of foreign entity is determined on a case-by-case basis considering the various attributions of the foreign entity and not only the tax treatment of the resident state of the hybrid entity. In addition to the classification of hybrid entities, these jurisdictions have introduced specific and targeted rules for anti-abuse of hybrid entities.

It has been established that not all jurisdictions follow the approach of linking the other jurisdiction entity's form into the closest domestic law equivalent as is the case in South Africa.

The secondary objective was also achieved which entailed obtaining an understanding of how the South African approach of classification and taxation of

hybrid entities actually operates, the implications and challenges of the applying the new foreign partnership tax legislation.

It has been established that, although South Africa has adopted the OECD approach of linking the foreign entity's tax treatment in the country of residence, it was equally important to carefully analyse and consider the implementation of the foreign partnership legislation prior to its introduction. From the work done in this research report, it has been established that there are still uncertainties on the application of this approach when it comes to deemed exit charges, asset take-on balances and available capital allowances for pre-existing entities on introduction of legislation as no transition guidelines were provided.

As the introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes, it was important to determine how this balance can be achieved which is discussed as part of the recommendations from the research report.

7.3 Recommendations

7.3.1 Anti-abuse rules

As can be ascertained above, many jurisdictions have introduced anti-abuse rules to target tax arbitrage arising from hybrid entities either through regulations or as specific provisions in the treaties. The anti-abuse provisions prevent cross-border tax arbitrage on account of mismatch in entity classification. The OECD in its report entitled 'Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues', recommended that countries introduce rules specifically addressing hybrid arrangements, these rules address multiple deduction of the same expense, deduction of payments which are not included in taxable income of the recipient, non-inclusion of income which is deduction at the level of the payer, and abusive foreign tax credit transactions (OECD, 2012: 13 - 18).

It is appreciated that South Africa is not a member of the OECD and therefore is not obliged to consider the recommendations issued by the OECD but South Africa is an observer. Some of these rules may have been catered for in the existing general anti-

avoidance provisions through the Act, it may be worthwhile revisiting the Act to ensure that the general anti-avoidance provisions adequately cover hybrid arrangements.

7.3.2 International competitiveness

The principles of anti-deferral or anti-avoidance and international competitiveness are diametrically opposed. Anti-deferral or anti-avoidance warrants complete taxation, whereas international competitiveness warrants complete exemption. In the end, South Africa needs to follow international norms favouring a balanced approach. Section 9D of the Act achieves this balance by favouring international competitiveness (that is exemption) where the income stems from active operations. Anti-deferral (that is immediate taxation) applies where the income stems from passive investments or from transactions that meet objective criteria with a high tax avoidance risk. (Engel, 2002:1).

Introduction of new tax legislation is generally faced with the balance between encouraging South African residents to remain internationally competitive and curbing tax avoidance schemes. With this statement in mind, it is submitted that it is equally important to highlight that the introduction of the foreign partnership tax legislation in South Africa should consider some of the exemptions available in section 9D of the Act as an exemption equivalent to the foreign business establishment and the so-called high tax exemption. Consideration of similar exemptions for hybrid entities will ensure that foreign entities with genuine commercial substance and reasons for establishing these hybrid entities are not inadvertently caught by these anti-avoidance provisions resulting in increased administrative burdens and reduced competitiveness for the South African resident shareholder or member.

7.4 Conclusion

In concluding this research it is submitted that the South African classification and taxation of hybrid entities is aligned with international approaches but consideration has to be made to the practical application of this legislation in order to eliminate any further uncertainties. The above recommendations should be considered to achieve the balance between anti-avoidance and international competitiveness.

8 REFERENCE LIST

8.1 Books

- Arnold, B. J. and McIntyre, M. J. (2002) *International Tax Primer*. 2ed The Hague: Kluwer Law International.
- Ault, H. J. and Arnold, B. J. (1997) *Comparative Income Taxation: A Structural Analysis*. The Hague: Kluwer Law International.
- Ault, H. J. and Arnold, B. J. (2004) *Comparative Income Taxation: A Structural Analysis*. 2ed The Hague: Kluwer Law International.
- De Koker, A. P. and Brinker, E. (2010) *Silke on International Tax*. (Last updated November) Durban: LexisNexis Butterworths.
- De Koker, A. P. and Williams, R. C. (2013) *Silke on South African Income Tax*. (Last updated August) Durban: LexisNexis Butterworths.
- Duke, J. R. and Jacobs, K. V. (2007) *Offshore Tax Strategies*. Kansas: Offshore Tax Press.
- McCahery, J. A., Raaijmakers, T. and Vermeulen, E. P. M. (2004) *The Governance of Close Corporations and Partnerships: US and European Perspectives*. Oxford: Oxford University Press.
- Oguttu, A. W. (2007) *Curbing Offshore Tax Avoidance: The case of South African Companies and Trusts*. (LLD dissertation University of South Africa)
- Olivier, L. and Honiball, M. (2011) *International Tax – A South African Perspective*. 5ed Cape Town: Siber Ink.

8.2 Journals

- Jones, J. F. A., De Broe, L., Ellis, M. J., van Raad, K., Le Gall, J., Torrione, H., Miyatake, T., Roberts, S. I., Goldberg, S. H., Killius, J., Maisto, G., Giuliani, F., Vann, R. J., Ward, D. A. and Wilman, B. (2002) 'Characterisation of other States' Partnerships for Income Tax', *Bulletin for International Fiscal Documentation* vol.56 (7): 288 – 320 [<http://www.ibfd.org/IBFD-Products/Journal-Articles/Bulletin-for-International-Taxation/collections/bit/pdf/bifd070202.pdf/>] (accessed 20 August 2013).

- Krahmal, A. (2005), 'Hybrid Instruments: Jurisdiction Dependent Characteristics', *Houston Business and Tax Law Journal*, vol.(5): 98 - 127 [<http://ssrn.com/abstract=918325>] (accessed 14 August 2013).
- Oguttu, A. W. (2009) 'The Challenges of Taxing Investments in Offshore Hybrid Entities: A South African Perspective', *South African Mercantile Law Journal*, vol. 21(1): 51-73.
- Sharma, V. and Sharma, A. (2013) 'Chapter 20 Cross Border Taxation of Partnerships' in *International Taxation – A Compendium* vol 4(3): 465-496 [http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Articles/Cross%20Border%20Taxation%20of%20Partnerships.pdf] (accessed 25 February 2014).

8.3 Articles

- Baker, P. (2002) 'The Application of the Convention to Partnerships, Trusts and Other Non-corporate Entities' [http://www.taxbar.com/documents/application_convention_pb_000.pdf] (accessed 24 July 2013).
- Bjornholm, N. and Hansen, A. O. (2005) 'Denmark in International Tax Planning' [<http://books.google.co.za/books?id=XiK8qw2xQXIC&pg=PA126&lpg=PA126&dq=classification+of+an+llc+for+Denmark+tax+purposes&source=bl&ots=F86vTNBZAy&sig=6F0gYN4lHhXMCHKn33o8rVofMRQ&hl=en&sa=X&ei=6vEOU4-UHsGUhQfl1IHIDA&ved=0CDkQ6AEwAg#v=onepage&q=classification%20of%20an%20llc%20for%20Denmark%20tax%20purposes&f=false>] pdf] (accessed 27 February 2014).
- Brinker, E. (2010) 'Tax Consequence of Foreign Partnerships' [<http://www.internationallawoffice.com/Newsletters/>] (accessed 29 July 2013).
- Castro, L. (2008) 'Hybrid Entities and Instruments: Are they adequately covered in the OECD Conventions' [<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=a152a081-8b1e-4ac2-b1be-5973e8e69bcd>] (accessed 25 July 2013).

- Correia, C. G. (2013) 'Digital realities – Base Erosion and Profit Shifting' [http://www.cralaw.com/cra_lisbon/assts/downloads/Base_erosion_and_profit_shifting.pdf] (accessed 6 August 2013).
- Deloitte (2010) 'BMF issues decree on treatment of partnerships under tax treaties' [<http://www.deloitte-tax-news.de/german-tax-legal-news/bmf-issues-decree-on-treatment-of-partnerships-under-tax-treaties.html>](accessed 5 February 2014).
- Dalton, J. (2012) 'Why linking rules not harmonisation will tackle double non-taxation' [<http://www.internationaltaxreview.com/Article/3033124/Why-linking-rules-not-harmonisation-will-tackle-double-non-taxation.html>](accessed 12 August 2013).
- Easson, A. and Thuronyi, V. (1998) 'Chapter 21 Fiscal Transparency' in *Tax Law Design and Drafting* (Vol 2) International Monetary Fund [<http://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch21.pdf>] (accessed 25 July 2013).
- Fibbe, G. (2009) 'EC Law Aspects of Hybrid Entities' [<http://www.ibfd.org/IBFD-Products/EC-Law-Aspects-Hybrid-Entities>] (accessed 27 February 2014).
- GRP Rainer Lawyers and Tax advisors. 'Company Law, GmbH & Co KG' [<http://www.grprainer.com/en/gmbh-co-kg.html>] (accessed 10 January 2014).
- Hanly, K. S. M. and Yip, K. H. (2011) 'Treatment of Hybrid Entities' [http://www.fasken.com/files/Event/16bde354-bb5e-42ec-a52c-605807bae11c/Presentation/EventAttachment/35cf0731-cd65-4a3a-ade2-657ab5c8637e/Federated_Press_Treatment_of_Hybrid_Entities_Sept_2011.pdf] (accessed 25 July 2013).
- Ingles, M. (2013) 'Partnership Tax Planning including "Hybrid" Structures' [http://www.mercia-group.co.uk/email/blog/Mercia_-_Solicitors_-_Partnership_Tax.pdf] (accessed 25 February 2014).
- Investopedia US. (2014) 'Definition of Unlimited Liability Corporation (ULC)' [<http://www.investopedia.com/terms/u/ulc.asp>] (accessed 25 February 2014).
- KPMG, (2010) 'Classification for Tax Purposes of Limited Liability Companies Organized under the Laws of States of the United States of America', August.
- La Grange, A. (2011) 'Foreign Partnerships now specifically addressed in the Income Tax Act' [<http://www.ensafrica.com/news/foreign-partnerships-now->

specifically-addressed-in-the-income-tax-act?Id=236&STitle=tax%20ENSight]
(accessed 29 July 2013).

- Low-Tax Global Tax & Business Portal ‘Germany Company forms’
[http://www.lowtax.net/lowtax/html/germany/germany_company_forms.asp]
(accessed 10 January 2014).
- McDermott Will & Emery. (2005) ‘New UK Rules on International Arbitrage’
[<http://www.mwe.com/publications/uniEntity.aspx?xpST=PublicationDetail&pub=4840&PublicationTypes=0c37aff3-0fa4-487b-ae40-09ee0164a996>]
(accessed 12 August 2013).
- McGowan, M. T., Thomson, A. and Hardwick, E. (2013) ‘Recent developments regarding entity classification for UK tax purposes: HMRC v. Anson – is a Delaware LLC “tax-transparent”?’
[<http://www.lexology.com/library/detail.aspx?g=7eee05e2-6afe-41c7-86a7-51842386586a>] (accessed 20 February 2014).
- Miller, M. J. and Zhang, L. (2010) ‘United States: Reflections on the Application of Income Tax Treaties to Hybrid Entities that Earn Non-FDAP Income’
[<http://www.mondaq.com/unitedstates/x/97314/Income+Tax/Reflections+on+the+Application+of+Income+Tax+Treaties+to+Hybrid+Entities+that+Earn+NonFDAP+Income>] (accessed 7 January 2014).
- OECD (2013) ‘Addressing Base Erosion and Profit Shifting’, OECD Publishing
[<http://www.loyensloeff.com/nl-NL/Documents/OECD.pdf>]
(accessed 9 April 2013).
- OECD (2012) ‘Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues’, OECD Publishing [<http://www.oecd.org/tax/exchange-of-tax-information/hybridmismatcharrangementstaxpolicyandcomplianceissues.htm>]
(accessed 8 August 2013).
- OECD (2008) ‘Model Tax Convention on Income and on Capital – condensed version’, OECD Publishing [http://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2008_mtc_cond-2008-en;jsessionid=366h58o975rc7.delta] (accessed 10 January 2013).
- OECD (1999) ‘The Application of the OECD Model Tax Convention to Partnerships’, OECD Publishing [http://www.oecd-ilibrary.org/taxation/the-application-of-the-oecd-model-tax-convention-to-partnerships_9789264173316-en] (accessed 28 August 2013).

- Peters, J. (2010) 'The Use of Hybrid Legal Entities in International Tax Reduction Strategies, Part III'
[http://www.worldcommercereview.com/publications/article_pdf/369]
(accessed 20 February 2014).
- PWC (2012) 'OECD Report on Cross-border Hybrid Mismatch Arrangements, UN publishes Model Double Taxation Convention', PWC US Inbound Newsletter, March [http://www.pwc.com/en_US/us/tax-services-multinationals/newsletters/us-inbound-tax/assets/pwc-publications-relevant-us-inbound-tax.pdf] (accessed 6 August 2013).
- PWC (2012) 'OECD Report: Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues', PWC Tax Policy Bulletin, April
[http://www.pwc.com/en_GX/gx/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-report-hybrid-mismatch-arrangements-tax-policy-compliance-issues.pdf] (accessed 12 August 2013).
- PWC (2012) 'Update on OECD Tax Projects', PWC Tax Policy Bulletin, October [http://www.pwc.com/en_GX/gx/tax/newsletters/tax-policy-bulletin/assets/pwc-update-oecd-tax-projects.pdf] (accessed 12 August 2013).
- PWC (2013) 'OECD's Action Plan Published on Base Erosion and Profit Shifting (BEPS)', PWC Tax Policy Bulletin, July
[http://www.pwc.com/en_GX/gx/tax/newsletters/tax-policy-bulletin/assets/pwc-oecd-beps-action-plan.pdf] (accessed 12 August 2013).
- Ramsay, C. (2010) 'UK Tax Treatment of US Hybrid Entities'
[<http://www.mondaq.com/x/104354/tax+authorities/UK+Tax+Treatment+of+US+Hybrid+Entities>] (accessed 25 July 2013).
- Ruchelman, S. C. (2008) 'Hybrid Entities in Cross Border Transactions: The Canadian Experience – The US Response',
[[http://www.ruchelaw.com/pdfs/Hybrid Entities in Cross Border Transactions 2008.pdf](http://www.ruchelaw.com/pdfs/Hybrid%20Entities%20in%20Cross%20Border%20Transactions%202008.pdf)] (accessed 25 July 2013).
- Schmidt, H. M. and Schmidt, C. (2008) 'Double Taxation of Profits from a Hybrid U.S. LLC',
[<http://www.gibsondunn.com/publications/Documents/SchmidSchmidt-DoubleTaxationofProfitsfromaHybridUSLLC.pdf>] (accessed 20 February 2014).
- Severino, M. (2012) 'Canadian Unlimited Liability Companies (ULC) – A Viable Vehicle for US Investors Expanding internationally'
[<http://www.collinsbarrow.com/en/cbn/publications/canadian-unlimited->

liability-companies-ulc-a-viable-vehicle-for-us-investor] (accessed 25 February 2014).

- SH+C German Auditors and Tax advisors ‘Legal forms of enterprises, GmbH & Co KG’ [<http://www.shc.de/german-tax-consultants.php/nr/4/kat/53/aid/149>] (accessed 10 January 2014).
- Taxand’s Take (2010) ‘Update on tax qualification foreign entities in the Netherlands’ [http://www.taxand.com/news/newsletters/New_decree_on_qualification_of_foreign_entities] (accessed 8 August 2013).
- Van der Made, B. (2012) ‘European Union: Consultation on double non-taxation within the EU’ [<http://www.internationaltaxreview.com/article/3001288/Search/European-Union/>] (accessed 12 August 2013).
- Wheeler, J. (2013) ‘Persons Qualifying for Treaty Benefits’, International Bureau of Fiscal Documentation, May [http://www.un.org/esa/ffd/tax/2013TMTTAN/Paper2A_Wheeler.pdf] (accessed 13 August 2013).
- Wittendorf, J. (2013) ‘International mismatches: BEPS and a Danish example’ [<http://www.internationaltaxreview.com/article/3196897/Search/International-mismatch/>] (accessed 12 August 2013).

8.4 Government Publications

- Engel, K. (2002) ‘National Treasury’s Detailed Explanation to Section 9D of the Income Tax Act’.
- Income Tax Act 58 of 1962.
- South African National Treasury. (2010) ‘Explanatory Memorandum on the Taxation Laws Amendment Bill 2010’.
- South African Revenue Service. (2011) ‘Comprehensive Guide to Capital Gains Tax (Issue 4)’ December. [<http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-CGT-G01%20-%20Comprehensive%20Guide%20to%20Capital%20Gains%20Tax%20-%20External%20Guide.pdf>] (accessed 2 August 2013).
- South African Revenue Service. (2012) ‘Tax Brochure for Non-Residents’ January.

- Taxation Laws Amendment Act 7 of 2010.
- Taxation Laws Amendment Act 24 of 2011.

8.5 Conference proceedings

- Cui, W (2012). Boston Congress Scientific Programme, Seminar B. ‘Cross Border Arbitrage’ Boston: China University of Political Science and Law, September.
[https://www.ifa.nl/activities/annual_congresses/Pages/2012_Boston_Congress_4.aspx] (accessed 8 August 2013).
- Taneja, G. (2006). Foundation for International Taxation, International Taxation Conference. ‘International Tax Issues involving Hybrid Entities’ Mumbai: Ernst & Young India
[http://www.fitindia.org/downloads/Gaurav%20Taneja_2006.pdf] (accessed 8 August 2013).
- Thuronyi, V. (2012). Committee of Experts on International Cooperation in Tax Matters, Eighth session. ‘Coordination Rules as a Solution to Tax Arbitrage’ Geneva: Tax Notes International, October
[http://www.un.org/esa/ffd/tax/eighthsession/CRP7_TaxArbitrage.pdf] (accessed 14 August 2013).

8.6 Table of Cases

- *Bayfine UK v HMRC* [2010] EWHC 609 (Ch).
- *Swift UK v HMRC* [2010] SFTD 553.