



University of the Witwatersrand, Johannesburg

An analysis of the taxation effects and considerations for multinational entities with dual residency issues, from a South African perspective.

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ABSTRACT

There has been significant advances in the international arena with regards to global economic growth and trade, as well as enormous competition by countries to attract inward foreign direct investment from multinational enterprises (MNEs) to ensure the sustainability of their own economies. Fundamentally the contentious issue is the possibility of double taxation (DT), due to the dual residency of the MNE. The MNE operates in various markets which results in cross-border transactions, whether physical or electronic, and this ultimately means that different tax jurisdictions will become applicable and enforceable by each relevant country. These dual resident MNEs could be seen as a tax resident in both countries and thus be liable for tax obligations in both of these countries. This would therefore lead to the same income incurring DT or double non-taxation (DNT), which would have a devastating impact on that MNE. This lead to the establishment of double taxation treaties, agreements and conventions (DTA's), between various countries which are aimed at addressing this imbalance. As technology advances at an alarming rate, so too does the possibility of abuse of tax treaties. Two important criteria are 'the place of effective management' (POEM) and the 'permanent establishment' (PE), which are critical to the determination of the correct tax jurisdiction where the dual resident MNE will incur various tax liabilities. These concepts, POEM and PE, can be confusing but are imperative, in order to prevent DT, and which could prejudice the relevant fiscus, as well as an attempt to avoid any conflict between the taxing regimes. An interesting facet of the POEM and PE conundrum is the interpretation by the Organisation for Economic Co-operation and Development's ('the OECD') Model Tax Convention (MTC) compared to the interpretations by the South African Revenue Service (SARS). Another area of contention for MNEs is the current enormous global focus on the concept of Base Erosion and Profit Shifting (BEPS), which is under great scrutiny, and is of great concern for the majority of revenue authorities. These authorities are intensifying their focus on improving and enforcing anti-avoidance provisions to prevent taxation leakage in their respective tax jurisdictions. This shift in priorities opposes one of a MNE's main business objectives which is to maximize profits, by either diverting, extracting and/or distributing profits out of a high tax paying jurisdiction into a lower tax paying jurisdiction. This will consequently create an additional business risk which emphasises the need for international tax expertise. The international tax expert is a valuable business team member, as their knowledge and expertise is imperative for the mitigation of possible tax risks, correct interpretation and application of the relevant tax legislation on the business flows of the MNEs as a result of operational expansion or any cross-border transactions or activities.

Key Words: Taxation, Tax Treaties, Agreements, BEPS, Conventions; Cross-border, Double Taxation; Dual Residency; International tax, Multinational enterprises; Permanent Establishment, Place of Effective Management; OECD Model Tax Convention; Tax Intelligence, Tax Jurisdictions

DECLARATION

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

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ABBREVIATIONS

Abbrev.	Description
APA	Advance Pricing Arrangements
BEPS	Base Erosion and Profit Shifting
BI	Business Intelligence
CFC	Controlled Foreign Company
CGT	Capital Gains Tax
CP	Cost Plus
C: SARS	Commissioner of the SARS
CUP	Comparable Uncontrolled Price
DNT	Double non-taxation
DT	Double Taxation
DTA	Double Taxation Treaties, Agreements and Conventions
DTC	Davis Tax Commission
EC	Exchange Controls
EUR	Euro (symbol - €), the official currency of the Eurozone
FDI	Foreign Direct investment
FOB	Free on Board
GAAR	General Anti-Avoidance Rule
GST	General Sales Tax
IFRS	International Financial Reporting Standards
IHC	Intermediary Holding Company
IN	Interpretation Note
MNE	Multinational Enterprise
MTC	Model Tax Convention
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
POEM	Place of Effective Management
RP	Resale Price
RR&I	Revenue, Risk and Intelligence
SAARs	Specific Anti-Avoidance Rules
SARB	South African Reserve Bank
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
TAARs	Targeted Anti-Avoidance Rules
TI	Tax Intelligence
TNMM	Transactional Net Margin
TOR	Terms of Reference
TP	Transfer Pricing
VAT	Value Added Tax
WT	Withholding Taxes
ZAR	Rand (symbol - R), the official currency of South Africa

CHAPTER 1. Introduction

1.1 Background

‘The tax “tail” should not wag the commercial “dog”. Once the decision to invest has been made, however tax is an important factor in determining the way in which the investment should be structured.’ - Arnold, B. and McIntyre, M. (2002)

International tax law is complex and it is currently the focus of the global business community. Although very complex, it has become the fundamental building block of any international business foot print and can be a contributing factor of success or failure of a multinational enterprise (MNE), in the short, medium and long term. A MNE is an enterprise that is incorporated and operates in one country (the home country), but also maintains operations in other countries¹ through cross-border expansion, trade and or investment.

The global markets are growing and expanding at an astonishing rate, with many new emerging markets entering the international arena and competing to establish themselves as economic participants. The competition is fierce as population numbers are rapidly increasing as never before, which puts a strain on the country's ability to provide for its citizens and is forcing companies to venture over their territorial borders and waters to ensure their survival and sustainability, thus becoming huge MNEs.² The technological advances, such as e-commerce and the internet, have also had an enormous impact on the world's markets, as the physical limitations, such as travelling, are reduced and access to previously restricted markets are now accessible. There are great areas of possible risk that is often neglected when MNEs rush into global business opportunities and sign contracts with foreign entities in pursuit of ensuring profits and positive triple-bottom lines, and these cross-border activities are directly related to the tax aspects and obligations which are associated with the relevant tax jurisdictions.

In the current global corporate environment there is copious amounts of sensitivity surrounding the corporate image of an enterprise; in relation to it being a good corporate citizen. Good corporate citizenship is currently a global topical issue, relating to the best practices related to corporate governance and the King reports, where compliance is key,

¹ Hungerford, T. (2014), p.2

² OECD (n.d. – h), p.2.

which includes tax compliance. The Southern African Institute of Directors, stated that the new King IV report would be an improved version of the King III report.³ This means that South Africa will maintain its leading position in the world, in terms of financial, legal reporting and corporate governance. In the Global Competitiveness Report 2013-2014⁴, South Africa was awarded the number one ranking by the World Economic Forum, for Efficacy of Corporate Boards, Protection of Minority Shareholders' Interests, Regulation of Securities Exchanges and Legal Rights Index. In order to list and maintain the listing on the Johannesburg Stock Exchange all companies are required to report on the extent to which they comply with the principles of the King Code on Corporate Governance, on an apply or explain basis.⁵

As MNEs eagerly venture into foreign business hubs, numerous complicated aspects of tax and the associated risks often become relevant, such as, dual tax residency issues which is directly related to possible DT or DNT on a single income stream. Dual residency easily occurs when the MNE is regarded as a resident in two or more states or tax jurisdictions in the same period. Due to the sometimes unusual and creative ways that MNEs set about avoiding this dual residency issue, it is regarded as a possible tax avoidance area by various revenue authorities. These authorities are particularly sensitive to this topic, as their main aim is in fact to collect revenue to contribute towards the government spending, which usually is extremely high therefore there is a huge amount of pressure to close the tax net.⁶

There is great potential for tax conflict when different tax jurisdictions are involved. In order to mitigate this, the correct interpretation and application of the tax laws in these jurisdictions, must be identified and managed. All aspects of the various international tax components must be considered. Of equal importance are the key elements that have to be considered is the determination of 1) is the legal entity regarded as a tax resident in that country and, 2) exactly where is the place of effective management.⁷

Many countries look to each other for guidance and watch recent developments in an attempt to provide alignment with the international models, solutions and guidelines. This alignment can also lead to conflicting legislation if the approach is implemented in a segmented approach and the whole issue is not considered at the same time. The OECD, which was established in 1961, is the key organization which brings the global arena of trade and

3 The Institute of Directors in Southern Africa

4 World Economic Forum, p.347

5 JSE, (2015).

6 Retief, E. (2015). SAIPA: Tax Update 2015.

7 Greene, C. (2015b). p.25

investment together.⁸ It provides a platform for governments and countries to share and offer solutions. As the OECD also provides many other forms of invaluable advice, information, analysis and comparisons, recommendations, networking opportunities, measurements for global flows of trade and investment and setting of international standards, amongst other things. Its objectives are clear; 'our analyses and recommendations are independent and evidence-based...'⁹. Their other objectives include: 'impeding the work of terrorists, tax dodgers, crooked businessmen and others whose actions undermine a fair and open society'.¹⁰

It must be said that the OECD MTC is seen as the international body which serves as the standard for most tax treaties. Its purpose is to provide mutually beneficial solutions and clarity to aspects such as DT to MNEs engaging in cross-border activities¹¹. It is not legally enforceable but is binding on its member countries and used as a guide for non-member countries for purposes of international tax interpretation. Cognizance must be taken that as at 1 March 2015, South Africa is not a member of the OECD, but is in fact one of the countries under the category of 'enhanced engagement countries'.¹² Interestingly, this category also includes countries like Brazil and China, who together with South Africa form part of BRICS (BRICS is the acronym for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa).

The OECD's current members include many of the first world economies, and many of whom have been members for years. This is an indication that if South Africa wants to ensure continued successful trade in the international arena it will have to step up and align itself with the OECD guidelines, at the very least.

In order to provide credence to the OECD's impressive standing, it currently has a budget of EUR357 million and releases approximately 250 new titled publications per annual.¹³ The OECD released the OECD Guidelines for Multinational Enterprises (the Guidelines), which are applicable to all MNEs which are headquartered in the 44 countries¹⁴ that have signed them. The Guidelines also serve as a useful guide for non-OECD members wishing to stay on par with international norms and standards. The Guidelines, are;

8 OECD, (n.d. - a).

9 *Ibid.*

10 *Ibid.*

11 Retief, E. (2015), *op.cit.*

12 OECD, (n.d. - a).

13 *Ibid.*

14 The 44 countries include all of the OECD members, OECD accession countries, and the G20 countries

.... recommendations of governments on the standard of business behaviour that is expected of multinational enterprises throughout their global operations. The Guidelines set out principles and standards in areas ranging from human rights, employment and industrial relations, to information disclosure, environment and taxation.¹⁵

Increasingly, MNEs are forced to make use of DTA's, as the intention of a DTA is generally to avoid or reduce double taxation between two tax jurisdictions. The DTA's are valuable mechanisms that provide tax relief and counter DT.

Appendix A, illustrates the enormous complexity and differing taxation rates in the various countries, in terms of corporate and indirect taxes, which could impact a MNE engaged in cross-border transactions.

Of course, there are numerous other current topical issues in the international taxation terrain, which are of such serious consequence that the taxing authorities are emphatically united in order to fight against these issues. To illustrate this joining of forces, the title of the article on the OECD website regarding the BEPS project, aptly sums it up; '....recommendations for a coordinated international approach to combat tax avoidance by multinational enterprises.'¹⁶

The international unification against BEPS, is clearly reflected in the seven BEPS reports delivered in 2014¹⁷, which were formulated through consensus of 44 countries¹⁸. These reports also involved an extensive consultation process with the developing countries, business, non-governmental organisations and other stakeholders.¹⁹ There are many taxation avoidance schemes and techniques which are frowned upon, which have warranted an appearance in the research report.

This research report will address the taxation effects and considerations that MNEs with dual residency issues are continually faced with, from a South African perspective, followed by specific focus on key issues, concepts and other considerations which can have a fundamental impact on the MNEs' business success.

15 OECD, (n.d. – h), p.52.

16 OECD, (n.d. - c).

17 OECD, (n.d. - c). p.5

18 The 44 countries include all of the OECD members, OECD accession countries, and the G20 countries

19 *Ibid*

1.2. The Research Problem

1.2.1 The Problem Statement

Practical issues and problems arise when the MNEs and their global trading partners enter into cross-border transactions and activities through international investment and business transactions. These activities unavoidably will involve engagement with different taxation jurisdictions, and this could lead to the enormous potential for exposure to a variety of risks for these MNEs.

The dual residency status which many MNEs will be faced with as a result of this cross-border activities, could impose huge financial losses, non-compliance issues, criminal prosecution and other related risks, such as possible DT on single revenue income streams.

1.2.2. The Sub-problems

There are a significant number of sub-problems which support the main research problem:

1. Misinterpretation of the taxation legislation across the various taxation jurisdictions could lead to devastating repercussions for the MNE, and negatively impact the macro economy of the affected countries in which they operate. There are many concepts and terminologies in the international taxation domain which could determine the success or failure of the MNE's cross-border activities. Unfortunately these concepts are not always understood, and in some instances there might not even be an awareness of them and their impact.
2. DTA's are crucial tools to assist the MNE in the fight against DT, but often the MNE is unaware of its full value. The MNE might be oblivious to the existence of a relevant DTA which could reduce or even eliminate any DT imposed on it through its cross-border activities. There is also the possibility of DNT that could impact on the non-tax of certain income streams due to gaps in tax legislation. This area of tax could be misunderstood because of the intricacies of DT and DNT, the application of and the beneficial advantages of making use of a DTA. MNE's are not always fully conversant with DTAs. This is of tremendous importance so that the MNE will be in a position to

contribute towards updating, reviewing, lobbying and ultimately possibly re-negotiation. This capability will ensure that the DTAs are transparent, constitutionally fair to both parties, as well as promote each country's investment and business opportunities for these MNEs.

3. An essential element of a successful business that MNEs often do not focus on is proper tax planning. Tax planning is an important tool used to negate the MNE's cross-border taxation risks, as well as highlight any associated non-taxation risks. Unfortunately the tendency is to down play the role of tax planning because it often requires significant investment in properly qualified tax professionals. Another reason is that the skills set of tax professionals across the globe and various tax authorities are not standardised. As a result there are varying approaches to the interpretation of legislation and understanding, etc. which compounds the ambiguity of the international tax complexities.
4. Practical evaluation and application of critical issues and factors for MNE's when considering international trade, investment and/or expansion of operations globally, is often extremely cumbersome and difficult. There is a fine line between aggressive tax planning, tax avoidance and tax evasion which must be kept in mind when addressing this area of focus.

1.3 Scope and limitations

The scope of this research report will look at the considerations, important concepts and offer some guidance for MNE's contemplating or are involved in international trade. The focus is on generic tax issues that may arise from this cross-border activities, as well as legislation, case law and treaties/conventions which are intended for the purpose of alleviating DT, and other tax issues.

Due to the vast number of DTAs established globally between the majority of the actively trading markets and countries across the international arena, it is not possible to discuss each. In attempt to provide a brief insight, Chapter 4 is dedicated to practical issues and considerations that a MNE could experience when entering into cross-border activities.

MNEs are subject to many other issues which are not related to tax, but for the purposes of this research report they will be mentioned on a very high level for awareness purposes but will not be dealt with in depth.

1.4 Research Methodology

The objective of this research is to highlight the aspects and practical issues which could affect the tax of MNEs that are faced with the possibility of DT due to dual residency status.

The research methodology adopted consists of various qualitative reviews and analysis, information collected from various electronic media portals, available literature, cases, news articles, developments in the relevant legislation and guidelines, which relate to this research report topic, which has and still is very topical, complicated and, at times controversial.

This review is one of a literature review of the South African versus international information, which includes legislation and guidelines, publications by various experts, journal articles, as well as, case law which are relevant to this research project. To add practical value, a short checklist has been attached, refer to Appendix C.²⁰ Based on this research and analysis, recommendations and possible conclusions will be made.

1.5 Chapter outline

Chapter 1 introduces the background, purpose and scope of the research report. It also explains the problems and sub-problems, methodology followed and limitations of this study.

Chapter 2 identifies the important concepts and terminologies that are key for MNE's to understand and be able to determine in order to prevent DT. If these terms are fully understood and considered, it addresses the first sub-problem by enabling knowledgeable determinations, promotions and support of proper decision making to either enter or continue with cross-border activities in terms of trade and/or investment by the MNE's.

Chapter 3 discusses DTAs, in order to address the second and third sub-problems. If the whole area of DTA is understood, it can be used as a tool against DT. The role of a DTA is

²⁰ Greene, C. (2015c).

to assist with DT and anti-avoidance initiatives, which also serve the objective of preventing the erosion of tax bases of the various tax jurisdictions.

Chapter 4 provides an insight into the critical underlying issues that a MNE must be cognizant of when considering international trade, investment and/or expansion of operations globally. This insight and the practical aid²¹ provided will contribute as a value- added service which will address all the sub-problems, in particular the third and the forth sub-problems.

Chapter 5 will present an overview of the findings of this research report, propose areas requiring further research and draw a conclusion as to possible initiatives, and the main underlying issues from a tax and non-tax view point. In addition, it will underpin the topical issues that affect the success of cross-border activities by the MNEs.

²¹ *Ibis*.

CHAPTER 2. Key concepts in the fight against double taxation for MNEs.

2.1 Introduction

‘Knowledge is power.’ — Abraham Verghese.

The main issue with MNEs is the potential possibility of them being classified as dual resident by the relevant tax jurisdictions in which they are active, and therefore the risk of a DT imposition on their cross-border income. The connotations associated with a MNE are usually double edged, on the positive side a MNE is seen as a necessity in terms of global expansion and sustainable economic growth for the economy of a country. On the negative side, many believe that a MNE is able to exploit unfair opportunities due to differences or overlaps in the domestic tax rules of the tax jurisdictions in which they operate in.²² The MNE could structure their business transactions in such a way so that they will not pay taxes anywhere,²³ giving rise to DNT. This non-payment of taxes is a result of gaps in the domestic tax systems which unwittingly allow the MNE to take advantage of not having an income stream taxed at all, known as DNT.²⁴

The MNE must ensure that its cross-border activities comply with the current climate of best practices, corporate governance principles and of course maximization of profits which are seen as the epitome of a successful business. Successful outcomes depend on the MNE being fully versed with and capable of understanding, considering and making proper informed decisions relevant to all aspects of international tax issues. This is necessary in order to not only achieve their full business and growth potential and at the same time to ensure that they are key business partners to the various countries in which they transact in. To assist with awareness and in terms of this research project, the aspects of the South African Income Tax Act ²⁵ (hereafter called ‘the Act’) will be used to illustrate general issues, practices and principles, and to avoid repetition all the below mentioned concepts that will focus on the stand point from a MNE perspective, and this is in reference to the various legislations clause; ‘...a person other than a natural person’.

²² Zetland Fiduciary Group Limited, (2013)

²³ *Ibis*

²⁴ Taxation of Multinational Companies, (2012)

²⁵ Income Tax Act 58 of 1962

There are numerous concepts in the international tax arena, and for the purposes of this research report there are a few that are of such immense relevance for a MNE, that they warrant discussion. These concepts need to be genuinely understood, contemplated and applied when considering or entering into cross-border activities by the MNE. The following list is not exhaustive, but should be used as a guide to assist in the battle against the imposition of DT on MNE's cross-border activities. Some concepts have required greater explanation, but all of them are equally important. The following concepts are explained by the use of explanatory commentary, as well as definitions (general/legislative and/or as per the OECD) where appropriate.

2.2 Important general concepts related to general international tax issues

2.2.1 Basis of tax (resident versus source)

There are two tax bases, being the resident and the source bases, which are used to determine the right to tax income earned by various revenue authorities.²⁶

In the South African tax landscape, an important change occurred in 2001²⁷, that with effect from the years of assessment commencing on or after 1 January 2001, the South African basis of tax would change.²⁸ The bases changed from a source to resident basis, which was a monumental change.

2.2.1.1 Source basis

This means that the MNE would be taxed on income generating activities that were derived from that particular country²⁹, this being the source basis of taxation. Thus the MNE's residence is not a consideration when determining the MNEs tax liability in that particular country.³⁰ The source is also applicable to non-resident MNEs as they are taxed on their actual or deemed South African income as a PE, although there are certain exclusions and/or exemptions from tax which may impact on whether SARS does have the right to tax the MNE, such as the application of a DTA.

²⁶ Katz, M. (1997).

²⁷ South African Reserve Bank. (2013) p.86

²⁸ Tax.co.za, (2015).

²⁹ Olivier, L. and Honiball, M. (2011), p.11.

³⁰ OECD, (n.d.- d)..

2.2.1.2 Resident basis

As the name implies it is based on the MNE's place of residence or domicile.³¹ Resident MNE's are taxed on their world-wide income, which means all income is taxed wherever in the world it is earned. Where the income is derived from is irrelevant, for example, if the MNE is a South African resident then it will be taxed on all income earned, whether from the inside and/or outside of South Africa.³²

2.2.2 Capital Gains Tax (CGT)

CGT is found in the Eighth Schedule of the Act, which states that taxable capital gains are added to the MNE's taxable income and is then included at 66.6% of the value of the net capital gain³³. There is no annual exclusion available for a MNE, and any capital losses incurred may not be set off against taxable income, but only against capital gains.

On the SARS website there are two excellent guides available which will assist with the understanding of CGT in South Africa, namely 'The comprehensive guide to capital gains tax'³⁴ and 'ABC of capital gains tax for companies'.³⁵ There was some positive news announced in the latest South African 2015 Budget Speech³⁶, that the highly controversial provision, being paragraph 11(2)(b) of the Eighth Schedule of the Act, although it was amended in 2013, it would again be revisited. Previously this provision had an impact on the situation when any South African company acquires foreign shares and pays for those foreign shares, in whole or in part, through an issue of its own shares. This event lead to the transaction being treated as a disposal for CGT purposes and immediately triggered CGT. The revision would broaden and relax this provision so that it will include any transaction in which any South African company issues any shares, in exchange for either new or existing foreign shares.³⁷

The Department of National Treasury's initial intention was to target the issuing of these shares which lead to the loss of control of the company in South Africa and moved the control of the MNE abroad. The provision in its current form severely caused inflexibility for

31 Katz, M. (1997), *op cit.* p.1

32 Tax, (2015).

33 Croome et al., (2013), p.335.

34 South African Revenue Service, (2011 - a).

35 South African Revenue Service, (2013).

36 South African Ministry of Finance, (2015)

37 Webber Wentzel, (2015); Webber Wentzel, (2014).

the South African MNEs when they wanted to enter into normal commercial transactions concerning acquisitions of shares in foreign companies.³⁸

2.2.3 Currency conversion

In the following situations all foreign currency must be translated into the South African currency before it is included in the South African resident MNE's income earned, and expenditure incurred,³⁹ by doing the following conversion:

- At spot rate on the date that the income is received or accrued, or the expenditure is incurred.
- If the income is attributable to a foreign PE:
 1. Determine the income in the functional currency used by the PE for purposes of financial reporting, and then;
 2. Translate it into South African Rand (ZAR) at the average exchange rate for the year.
- For CFC purposes, the net income is translated at the average exchange rate and it is then used to determine the foreign tax rebate permitted in terms of section 6quat of the Act.

2.2.4 Exchange Controls

In South Africa the SARB is responsible for the administration of EC. The SARB has delegated these administrative powers to authorised agents which act on its behalf in terms of the EC Rulings. South Africa imposes EC over South African residents and transactions between a resident and non-resident.⁴⁰ A MNE must obtain the necessary EC approvals for transactions involving the flow of funds between South Africa and the foreign country, as well as submit the required reports to the SARB or its authorised agents⁴¹.

³⁸ *Ibis*.

³⁹ Greene, C. (2015c). *op cit*. p.10

⁴⁰ Greene, C. (2015b). *op cit*, p.73

⁴¹ Authorised agents refer to major banking institutions nominated by the SARB

ECs do not affect the MNEs tax liability and obligations, but they do have to be strictly adhered to as it is an offence not to submit the required reports. These reports are used as a tool by the SARB to monitor the flow of foreign funds. Another verification tool is the SARS VAT return which the MNEs and other organisations complete and submit. The SARS VAT return contains mandatory sections which require disclosure of imports and exports of goods and services. This disclosure is an effective verification tool when comparing the VAT return to the EC disclosures made to the SARB or its authorised agents.⁴²

EC structuring and compliance is an integral part of cross-border strategy planning. It is advisable that the MNE obtains tax planning and advice from credible, experienced international tax professionals. Of special importance is the risk area of EC related matters, as they apply to both resident and non-resident MNEs.⁴³

In the South African 2015 Budget Speech,⁴⁴ the current Minister of Finance, Mr. Nhlanhla Nene, announced that ECs would continue to be relaxed⁴⁵. The corporate allowance for Foreign Direct investment (FDI) has been increased from ZAR500 million to ZAR1 billion,⁴⁶ per annum. It remains to be seen if the conditions and limitations attached to the FDI allowance will also be relaxed. This change has been welcomed as it is an attempt to make South Africa more attractive in terms of investment and trade, especially for MNEs.⁴⁷

An important South African court case is the one of *Shuttleworth v South African Reserve Bank*⁴⁸, which has had a major impact on ECs in South Africa. After receiving a favourable judgment, Mark Shuttleworth blogged the following apt quote which encapsulated the state of the South African ECs at the time; 'Exchange controls in South Africa provide no economic guarantees of stability, but drive up the cost of cross-border relationships for everyone'.⁴⁹

42 Retief, E. (2015) *op.cit.*

43 Greene, C. (2015b).

44 South African Ministry of Finance, (2015)

45 ENS Africa, (2015)

46 *Ibis*.

47 Retief, E. (2015) *op.cit.*

48 *Shuttleworth v South African Reserve Bank* (864/2013) [2014] ZASCA 157

49 Shuttleworth, M. (2015).

This case is responsible for the announcement in the South African 2015 Budget Speech,⁵⁰ where it was stated that the SARB would re-write of the EC manual.

2.2.5 Gross Income (GI)

In the case of South Africa, any income can be taxed by SARS if it meets the definition of GI, which is defined in section 1 of the Act as:

- (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
- (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic....

Thus it is important to note that this is applicable to income earned by both non-residents and residents, and the determining factor of exactly which income is taxed, this was elaborated on further in point 2.2.1 of this report.

2.2.6 Interpretation Notes (IN) - SARS

In the South African context, SARS provides INs⁵¹ which are intended to provide guidelines to stakeholders regarding the interpretation and application of the provisions of the legislation administered by the C: SARS. There are currently 85 INs available on the SARS website⁵².

An important warning which must be noted, is that the SARS's IN's serve as only as a guideline and do not have any legal standing, nor are either SARS or the courts bound by them.⁵³ This caution was stated in ITC 1675⁵⁴, which has caused great concern and confusion for many taxpayers.

⁵⁰ South African Ministry of Finance, (2015)

⁵¹ SARS Legal & Policy - Interpretation & Rulings - Summary of all Interpretation Notes, (n.d).

⁵² *Ibis*.

⁵³ Olivier, L. and Honiball, M. (2011), *op cit*, p 82

⁵⁴ ITC 1675 (2000) 62 SATC 219

2.2.7 Legal entity

The ordinary meaning is;

An association, corporation, partnership, proprietorship, trust⁵⁵, or individual that has legal standing in the eyes of law. A legal entity has legal capacity to enter into agreements or contracts, assume obligations, incur and pay debts, sue and be sued in its own right, and to be held responsible for its actions.⁵⁶

Legal entities link directly to the MNE's tax issues, such as, the determination of residency; where a head office and its branch are seen as one legal entity; and for residence purposes the South African MNE's foreign branch would be taxable in South Africa.

There is a distinction made for a MNE's foreign subsidiary, as this is a separate legal entity. The obvious issue would be if that MNE is a South African resident. SARS will want to tax that subsidiary, as well as the foreign state. In this situation a DTA or section 6quat rebate is extremely valuable and may be utilised to avoid DT.⁵⁷ If a DTA does exist with the relevant foreign country, the DTA will determine which tax jurisdiction will have the right to tax the MNE's in respect of the foreign income earned there. Usually the foreign income would be taxed in the foreign state where the business profits of the foreign subsidiary are made.⁵⁸

2.2.8 Resident

Residence is a central concept in the international tax rules of a country.⁵⁹ The OECD defines a resident as; 'A person who is liable for tax in a country or state because of domicile, residence, place of management, or other similar criterion'.⁶⁰

⁵⁵ Although a Trust is not a legal entity, it is defined as a 'person' in the Act.

⁵⁶ Business Dictionary, (n.d).

⁵⁷ Greene, C. (2015a), p.3

⁵⁸ *Ibis*

⁵⁹ Thuronyi, V. (1998), p.11.

⁶⁰ OECD, (n.d. - d).

A resident is defined more broadly, in section 1 of the Act, as any:

(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic, but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation.

2.2.8.1 Residency

The OECD defines the term residency as;

Residence is a basis for the imposition of taxation. Usually a resident taxpayer is taxed on a wider range of income or other taxable items than a non-resident. Residence in a state is a criteria for invoking a tax treaty of that state, and residence for treaty purposes involves considering the domestic law of residence for tax purposes, and then the requirements in Article 4 of the OECD Model, especially in the case of tiebreaker tests in cases of dual residence.⁶¹

Most tax jurisdictions impose taxes on a residency basis and in this regard South Africa is no different. Thus, if a MNE met either of the residency requirements it would be considered to have its place of residence in South Africa. This means that if the MNE is incorporated, established or formed in South Africa or has its POEM in South Africa, it is seen as being a South African resident. It is important to note the exclusions which are relevant when the MNE is deemed to be a resident of another country in terms of a DTA.⁶² To understand what is meant by 'incorporated, established or formed in South Africa', we need to look at section 14 of the Companies Act,⁶³ where it refers to specific registration requirements. If these requirements are met then the MNE would be deemed to be a South African resident. POEM is discussed later in this chapter. Cognisance must be taken that a headquarter company is excluded from the definition of a 'resident',⁶⁴ and if it is not a resident it cannot make use of a DTA.

⁶¹ *Ibis*

⁶² Taxsummaries, (2014)

⁶³ Companies Act 71 of 2008

⁶⁴ South African Revenue Service, (2011 - b); South African Tax Guide, (n.d.).

An interesting fact is that the Value-Added Tax Act (hereafter referred to as ‘the VAT Act’)⁶⁵ and the Act define a resident in the same way. The only difference is that the VAT Act also includes a non-resident who is carrying on ‘an enterprise or other activity’ in South Africa and has a fixed place in South Africa relating to such enterprise or other activity. The South African 2015 Budget Speech⁶⁶ stated this definition would be amended ‘to remove anomalies’, which is unclear as to what exactly this means but the assumption is that this statement is referring to the meaning of ‘other activity’.⁶⁷

2.2.8.2 Deemed Residency and section 9D of the Act

An important concept is that of deemed residency, which might not be obvious, but it is seen often. If income is deemed to be a resident’s, it simply means that even though it is actual produced or earned in another tax jurisdiction, it is still seen as South African income.⁶⁸ Section 9D of the Act, is a clear example of deemed residency as it taxes CFC’s imputed income in the hands of the South African residents in their proportion of the income earned, even though the income was earned in the foreign country.

2.2.8.3 Dual Resident

Due to the increase in international trade, there has been an increased incidence of dual residency classifications which could result in a potential for DT or DNT.⁶⁹ The OCED definition is; ‘...company resident in two or more countries under the law of those countries, because the two countries adopt different definitions of residence’.⁷⁰

When two tax jurisdictions treat the same MNE as a ‘resident’ for tax purposes, the MNE is then referred to as a dual resident, then both jurisdictions may have taxing rights.⁷¹ To assist the MNE in this position the OECD MTC has Article 4(1) which states that the MNE is a resident if it is liable for any tax due by the MNE’s; ‘...domicile, residence, place of management or any other criterion of a similar nature’.⁷²

65 Value-Added Tax Act 89 of 1991

66 South African Ministry of Finance, (2015)

67 Webber Wentzel, (2015), *op.cit.*, ‘Resident of the Republic’

68 Croome et al., (2013), p.35.

69 Schäfer and Spengel, (2002).

70 OECD, (n.d.- d).

71 Croome et al., (2013) p.564.

72 OECD (n.d – g), Article 4(3).

To alleviate this DT over the residence conflict, countries have entered into DTAs with each other. These DTAs usually have tie-breaker rules that assist with allocating and resolving which state will see the MNE as a resident for purposes of the DTA.

For the dual-resident MNEs there can be issues that are not adequately addressed in the DTA, especially the claiming of double deductions. The claiming of double deductions is seen as a serious risk and in order to prevent this a number of countries have enacted rules denying deductions to dual-resident companies in certain cases.⁷³ This is further discussed in Chapter 3, of this report.

2.2.9 Permanent Establishment (PE)

A PE, in terms of a DTA, is of the utmost importance as it demarcates the activities that the MNE of one contracting state (the residence state) must conduct in the other contracting state (the source state) before the profits generated from these activities may be subject to tax in the source state.⁷⁴ If a non-resident has a PE in South Africa, the PE is taxed in South Africa, on the income derived from a South African source. When it comes to capital gains, non-residents will be subject to CGT on assets attributable to a PE in South Africa.⁷⁵

In terms of Article 5 of the OECD MTC,⁷⁶ it defines a PE in Article 5(1) as; ‘...a fixed place of business through which the business of an enterprise is wholly or partly carried on’.⁷⁷

Not only is a PE a fixed place of business through which the residences’ business is conducted but it can also be established in other ways⁷⁸, such as:

- By providing services by the MNE’s employees in that foreign state, even if not permanently but for short periods of time; or
- Through the use of a dependent agent, which is dependent on the MNE, and is a resident in that foreign state.

73 Thuronyi, V. (1998), *op.cit.*, p. 16

74 Greene, C. (2015b).

75 Taxsummaries, (2014), *op.cit.*

76 OECD, (n.d. – g), Article 5

77 *Ibis*.

78 Greene, C. (2015b). *op cit*, p.6

If no PE is formed, then the MNE's business profits will be exempt from tax in the foreign state, but that state may still impose withholding taxes (WT) on certain income types, such as, royalties, interest, dividends and service fees.⁷⁹

2.2.10 Place Of Effective Management (POEM)

When a MNE is faced with a dual-residence problem, the concept of POEM is of great importance, but it also creates substantial uncertainty. The term 'resident' holds the key to resolving this problem, and it is defined in point 2.2.8 of this report. This definition includes a POEM test as one of the tests to determine the residence of a company.⁸⁰ Unfortunately the Act does not contain a definition for POEM, and even the South African Revenue Services (SARS) acknowledges that the determination of POEM is challenging⁸¹. The definition problem has a major impact on offshore MNEs as there is a risk that they could be determined, by SARS, to be a South African tax resident on the basis on their POEM and thus will be assessed and liable for tax in South Africa.

Other issues faced by the revenue authorities are the advances in technology, modernisation and sophistication of the business world which has ultimately led to a subtle flexibility in manipulating the POEM. This can lead to a situation where the members of senior management may not all be located in one place. The place where formal meetings of a board of directors or similar body meets could have minor or even no connection with where decisions are really made. Another factor compounding the confusion, is what is actually meant by the phrase 'effective management'.

SARS's view differs from the international view in respect of the meaning of POEM. The OECD MTC Commentary on Article 4⁸², refers to POEM as the place where the key decisions affecting the company, as a whole, are taken. This means that this will ordinarily be where the most senior person or group of persons make decisions, the place where the actions to be taken by the entity as a whole are determined. Notably there can only be one POEM at any point in time.⁸³

⁷⁹ *Ibis*.

⁸⁰ KPMG, (2015).

⁸¹ South African Revenue Service, (2011 - b), p.4.

⁸² OECD (n.d -g), Article 4(3)

⁸³ South African Tax Guide, (2013)

When we compare this to SARS's view, we need to look at their explanation in IN 6 (Refer to warning in point 2.2.6 of this report), which has caused great concern and confusion for taxpayers establishing MNEs. This IN states that you need to look where the company is managed on a regular or where the day-to-day operations of the entity is managed and controlled irrespective of where the overriding control is exercised, or where the board of directors meets. POEM is where policy and strategy decisions made by the directors and where they are implemented, not where they are taken. This means that to be South African tax residence, the determination is to where that company is effectively managed from, and not necessarily simply where that company has been incorporated.⁸⁴

POEM is usually the determining factor (except in USA DTA'S) when there is a dispute with a DTA when establishing under which tax jurisdiction does the company fall. If it is found that the MNE does not have its POEM in South Africa, it will not be a resident from a POEM perspective and will not be subject to tax in South Africa. The MNE will then only be taxed on its South African sourced income. If that POEM is found to be in any other country, the MNE will be entitled to invoke treaty relief in relation to any of its income that is derived from a source within South Africa.

POEM has not yet been fully tested in a South African court of law, so this means that SA taxpayers have no clarity on how the courts in this country are likely to interpret POEM. In the case of *Oceanic Trust v Commissioner of SARS*⁸⁵ which addressed POEM, the court seemed to be in agreement with the international interpretation. The South Africa courts interpretation of legislation has a nexus with international legislation. The South African Constitution⁸⁶ places a requirement on these courts that they should not give a judgment without consideration of international interpretations⁸⁷. It must be noted that the recently issued discussion document on IN6 by SARS on POEM, indicates that SARS is likely to follow the OECD guidelines.⁸⁸

84 South African Revenue Services, (2002).

85 *Oceanic Trust Co. Ltd N.O. V C:SARS* (case number 22556/09)

86 Constitution of the Republic of South Africa Act 108 of 1996

87 *Ibis*; section 233

88 EY, (2012).

2.3 Some important anti-avoidance Concepts

2.3.1 Anti-avoidance rules: GAARs, SAARs and TAARs⁸⁹

Anti-avoidance rules are classified into categories of general and specific categories. General anti-avoidance rules (GAAR) are broad principles-based rules within a country's tax system designed to counteract the perceived avoidance of tax. GAAR is used by the revenue tax authorities as a mechanism to deny the tax benefits of transactions or arrangements believed not to have any commercial substance or purpose other than to generate the tax benefit(s) obtained. In cases where particular transactions of concern are focused on it is termed as either specific anti-avoidance rules (SAARs) or, less commonly, targeted anti-avoidance rules (TAARs).⁹⁰

2.3.2 Base Erosion and Profit Shifting (BEPS)

This is a very topical and contentious issue which has been continually debated in various international forums. The OECD describes BEPS;

...as tax planning strategies exploiting gaps and mismatches in tax rules so that profits disappear for tax purposes or profits are shifted to locations with little or no real activity and where profits are subject to little or no taxes.⁹¹

Some MNEs legally avoid paying tax due to BEPS, which is a huge disadvantage to the domestic companies, due to the profits being shifted out of them. This area of concern is causing an enormous distortion and is creating a competitiveness gap between those MNEs engaging in BEPS and, domestic companies who cannot engage in this practice.⁹²

The OECD has come up with a BEPS Action Plan,⁹³ in an attempt to redefine and innovate positive modernisation of the tax of companies across the globe. The main objections of the BEPS Action Plan are to develop a new set of standards designed to avoid DNT, aligning taxing rights with substance and improve transparency. This is of particular importance to MNEs as many have not evaluated the actual consequences of this BEPS

⁸⁹ EY, (2013)

⁹⁰ *Ibis*.

⁹¹ Musviba. N, (2014a)

⁹² *Ibis*.

⁹³ OECD, (n.d - b)

Action Plan on their cross-border activities. The BEPS Action Plan has reflected the major evolution in the international tax arena, whereby economies, both developed and developing, have come together and are unified in their approach to finding solutions for this common problem.⁹⁴

This concept links directly to TP issues. Unfortunately the SARS guidance on this matter is old and therefore will not be discussed in order to prevent outdated information from being disseminated. It must be noted that the same set of rules apply to both large and small businesses, which in itself is problematic.⁹⁵

In the South African Budget Speech 2015,⁹⁶ there was a strong focus on the OECD BEPS project and the connection to South Africa. There is a move towards greater strengthening of the ability to apply TP rules to prevent BEPS from South Africa to lower tax jurisdictions.⁹⁷

MNE will have to brace themselves for more detailed questions in their ITR14, which is the South African corporate tax return. These questions will provide SARS with a way to identify taxpayers or transactions with potential BEPS activities, especially where an MNE engages in cross-border transactions, particularly with connected parties. It must be stressed that answering these questions incorrectly can have enormous detrimental ramifications for the MNE as this would void the usual prescription (the statute of limitations) on matters relating to the issue.⁹⁸

⁹⁴ *Ibis*.

⁹⁵ Retief, E. (2015) *op.cit.*

⁹⁶ South African Ministry of Finance, (2015)

⁹⁷ Webber Wentzel, (2015), *op.cit.*

⁹⁸ Retief, E. (2015) *op.cit.*; Webber Wentzel, (2015), *ibis*.

2.3.3 Conduit company

This concept links directly to the IHC, and many revenue authorities view this as a tax avoidance structure. The OECD defines a conduit company as;

Company set up in connection with a tax avoidance scheme, whereby income is paid by a company to the conduit and then redistributed by that company to its shareholders as dividends, interest, royalties, etc.⁹⁹

2.3.4 Controlled Foreign Company (CFC) – section 9D of the Act

The OECD defines a CFC as;

Companies, usually located in low tax jurisdictions that are controlled by a resident shareholder. CFC legislation is usually designed to combat the sheltering of profits in companies resident in low- or no-tax jurisdictions. An essential feature of such regimes is that they attribute a proportion of the income sheltered in such companies to the shareholder resident in the country concerned. Generally, only certain types of income fall within the scope of CFC legislation, i.e. passive income such as dividends, interest and royalties.¹⁰⁰

This concept of CFCs can be found in various sections of the Act, paragraphs of the Eighth Schedule¹⁰¹ and section 9D of the Act. These sections of the Act are known as anti-avoidance provisions, which determines that certain foreign sourced income generated by South African CFCs are subject to tax in South Africa.

A foreign company is a CFC if more than 50% of its shares (participation rights) or voting rights are held collectively by foreign residents. If a South African residence (together with any connected person) holds at least 10% of the participation rights (shares) in the CFC, then the income of the CFC must be imputed into the residents' taxable income.¹⁰²

⁹⁹ OECD, (n.d.- d).

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.*

¹⁰² SAICA, (2009)

Imputation means that an amount equal to the resident's proportionate share of the CFC's income must be included in the resident's income, for example, if a resident holds 78% of the shares in a foreign subsidiary, 78% of the foreign subsidiary's income is imputed.¹⁰³ There are exemptions which could apply to where this imputation is not required and thus will not be taxed in the hands of the South African resident. These exemption apply if the CFC is situated in a high tax jurisdiction. It must be noted that in terms of the new amendments¹⁰⁴, the net income of a CFC will be deemed to be nil if it meets following requirements:¹⁰⁵

1. The CFC must be subject to a tax rate of at least 75% of the normal tax that the CFC would have paid had it been a resident. At the current corporate rate of 28%, this is 21%¹⁰⁶.
2. The CFC must be subject to tax by the relevant government in the country in which it is incorporated; and
3. The net income of the CFC must be subject to foreign tax payable of at least 75% of the amount of tax that would have been imposed had the CFC been taxable in South Africa. This aggregate tax payable in the foreign tax year is only determined after any DTA or rebate or credit or other tax recovered in that foreign tax jurisdiction is taken into account. It is calculated after any assessed losses has been disregarded.¹⁰⁷ If the CFC has a fixed foreign business establishment that it relies upon economically, in the foreign country, then four components must be present before this foreign business establishment exists. Three of these components must relate to the nature of the business and the fourth must relate to its purpose.¹⁰⁸ This CFC income includes capital gains. For this income to be exempt the CFC must operate at an arm's length.¹⁰⁹

103 Greene, C. (2015a), *op cit*, p.3.

104 South African Ministry of Finance, (2015)

105 SAICA, (2009), *op.cit.*

106 $28\% \times 75\% = 21\%$

107 Greene, C. (2015a), *op.cit.*, p.8

108 SAICA, (2009).

109 Greene, C. (2015a), *op.cit.*

In the South African 2015 Budget speech¹¹⁰, it was stated that the definition of a CFC will be broadened, so that SARS can bring more companies owned by trusts into its tax net¹¹¹. An interesting fact was that in the year 2011, the diversionary rules associated with South Africa exports to a CFC were removed from South Africa legislation. Unfortunately it was stated that these rules will be re-instated because the South African Department of National Treasury feels that these rules are far more effective than TP rules when it comes to addressing BEPS in South Africa¹¹². These rules ensured that the sale of goods sourced by the CFC from connected parties in South Africa, would be imputed into the South African residents' income. This will negatively impact MNEs as the Department of National Treasury acknowledged that these rules are 'overly mechanical' in their application.¹¹³

2.3.5 Tax treaty (also referred to as a Double Taxation Convention, Treaty or Agreement)

The OECD defines a tax treaty as; 'An agreement between two (or more) countries for the avoidance of double taxation. A tax treaty may be titled a Convention, Treaty or Agreement'.¹¹⁴

This concept is discussed in more detail in Chapter 3 of this research report, but in summary a DTA is one of the main core concepts in preventing DT from being levied on the same income stream. A DTA allocates the taxing rights where the DT potentially arises. Normally the DTA will provide relief in accordance with the country of residence's fiscal laws or it will provide for a different method of eliminating DT.¹¹⁵

2.3.6 Hybrid mismatch arrangements

According to the OECD a hybrid mismatch arrangement is one; '...that exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries'.¹¹⁶

110 South African Ministry of Finance, (2015)

111 Webber Wentzel, (2015), *op.cit.*

112 Retief, E. (2015)

113 *Ibis*.

114 OECD, (n.d. - d)

115 Greene, C. (2015a), *op cit.* p.3

116 OECD, (n.d.- e)

The effect of these arrangement is that they often lead to DNT, in the form of direct or a tax deferral, which obviously would not have been the intention by either country.¹¹⁷ They are common BEPS instruments because it is used to achieve a double deduction with no corresponding tax inclusion,¹¹⁸ and the effect is a competitive advantage over other companies, and causes other economic inefficiencies.¹¹⁹

There could be a disjoint in the classification between tax jurisdictions as these hybrid instruments may be seen as debt in one jurisdiction and an expense in the other jurisdiction.¹²⁰ Anti-avoidance provisions have been set out in sections 8E, 8EA, 8F, and 8FA of the Act, in this regard.

2.3.7 Intra-group transactions (section 45 of the Act)

In the latest South African 2015 Budget speech,¹²¹ it was said that the anomalies in this section of the Act has now been corrected.¹²²

Intra-group debt issued to fund section 45 transactions is deemed to have a nil tax cost in terms of section 45(3A) of the Act, which was introduced several years ago as an anti-avoidance measure. The repayment of such debt is, however, disregarded for tax purposes, so long as such repayment also takes place within an intra-group context. In effect, section 45(3A) of the Act seeks to ensure that intra-group debt arising is also settled within the same group of companies, and not transferred or ceded to a third party.¹²³

2.3.8 Intermediary Holding Company (IHC)

An IHC is often linked to the concept of a conduit company (refer to point 2.3.3), and it also referred to as an immediate holding company. The Business Dictionary defines an immediate holding company as;

¹¹⁷ *Ibis*.

¹¹⁸ OECD, (n.d. – g)

¹¹⁹ Porter, N. (2014). The South African Headquarter Company Regime: Can this be Considered an Effective Intermediary Holding Company Regime? Masters of Commerce. University of the Witwatersrand, Johannesburg .p.96

¹²⁰ Porter, N. (2014), *op.cit.* p.90

¹²¹ South African Ministry of Finance, (2015)

¹²² Retief, E.(2015) *op.cit.*

¹²³ *Ibis*.

A company which maintains the controlling interest in a different company despite the fact the company itself is held by another entity. The company which holds control over both companies is considered to be the holding company.¹²⁴

An IHC is a company that is interposed between two companies, and this provides both commercial and tax benefits for the companies. The IHC is a subsidiary of one company and a holding company of another company. By its nature, an IHC cannot be an ultimate holding company.¹²⁵ At least one of the companies between which it is interposed should be located in a jurisdiction other than that of the IHC itself.¹²⁶ The clear advantage for MNE's is that there is a pooling of funds in this jurisdiction and it is not under any EC. The IHC is able to obtain a lower effective tax rate as compared to a company which is not a MNE and thus is not limited to a single tax jurisdiction.

SARS generally views the formation of an IHC¹²⁷ as suspicious and as a possible anti-avoidance vehicle. This view makes sense because they are usually located in a more favourable tax regime, normally it has a lower tax rate than South Africa and any active income is usually sheltered in that tax jurisdiction. The lower tax jurisdiction usually has an extensive treaty network to protect the income and prevent DT by reducing any WT on items such as dividends paid by foreign subsidiaries to IHC. Some IHCs could distribute dividends to the ultimate shareholder without incurring WT on dividends in the jurisdiction of the IHC.¹²⁸

Another bone of contention is that normally the IHC is effectively managed outside of South Africa which ensures that it is not a South Africa tax resident company.

2.3.9 Thin capitalisation

This practice is commonly seen as BEPS instrument, as thin capitalisation is the practice of excessively funding a branch or subsidiary with interest-bearing loans from related parties rather than with share capital.¹²⁹ Thin capitalisation is favoured by MNEs because the interest is usually deductible for the borrower and the lender is taxed at a low rate of

124 Business Dictionary, (n.d).

125 Olivier, L. and Honiball, M. (2011), *op.cit.*, p.297

126 *Ibid.*

127 In South Africa a IHC is referred to as Headquarter Company

128 Greene, C. (2015a), *op cit*, p. 7

129 Retief, E. (2015) *op.cit.*

WT, as opposed to declaring dividends which are fully taxed in the hands of the investor, unless a DTA directs otherwise.

Thin capitalisation rules seek to deal with this problem by denying deductions for interest in defined cases and possibly re-characterising the payments of interest as dividends.¹³⁰ Although it is possible to deal with these problems under the arm's length principle, MNEs often require guidance on what is permissible loan funding for a subsidiary, so that it is not viewed as thin capitalisation.

2.3.10 Transfer Pricing (TP) - section 31 of the Act

Transfer pricing (TP) is seen as one of the major BEPS instruments used currently by MNEs trying to escape tax. TP is the general term used to refer to the problem of allocating profits to various entities which form part of the same corporate group.¹³¹

TP relates to the pricing of inter-company and related-party transactions involving transfers of tangible and intangible property, services, or financing between affiliated entities, where many entities use TP for tax planning, whereby the transaction profit is moved from a jurisdiction with a higher tax rate to one where the tax rate is lower.¹³²

In financial accounting, this is not an issue as the MNE group is seen as a whole and, intra-group and inter-group transactions are eliminated on consolidation in order to determine profits for reporting to shareholders and other stakeholders. Whereas in tax, there is a totally different requirement as it is necessary to allocate profits among the companies in the group because under tax norms a country will tax a non-resident only on the profits sourced in that country.¹³³ While the country can tax a local (resident) subsidiary on its profits worldwide, affairs within a MNE group will usually be arranged so that the subsidiary only has profits sourced in that country.¹³⁴

The detailed interpretation and practical application of TP tax provisions are usually extremely complex and it is advised that TP tax specialists should be consulted in determining tax exposures in complex group arrangements.

130 Thuronyi, V. (1998), *op.cit.*, p.64

131 OECD (n.d - d).

132 Greene, C. (2015b), *op.cit.*

133 Retief, E. (2015) *op.cit.*

134 Thuronyi, V.(1998), *op.cit.*, p.64

The areas where TP could be evident are in respect of transactions,¹³⁵ such as:

- foreign interest-free or low interest loans to connected persons;
- sale of goods to/or purchases from connected persons; and
- the providing of services to, or receiving services from, connected persons.

If TP is not at arms-length, SARS makes a primary adjustment to the tax calculation.¹³⁶ In South Africa there have been some interesting developments surrounding TP and the notorious section 31 of the Act, which was enacted to prevent excessive extraction of value from the South African tax base in the form of interest deductions regarding loans from foreign connected persons. The TP and thin capitalization rules have now been merged under section 31 of the Act,¹³⁷ as amended by the Taxation Laws Amendment Act,¹³⁸ with the main focus on cross-border transactions or activities.¹³⁹ The result of this amendment is that now there is no SARS intervention, as before where SARS would make a TP adjustment to bring the transaction in line with an arm's length transaction, now the MNE is expected to account for TP on an arm's length basis on its own.¹⁴⁰

There are various methods to determine an arm's length price, where South Africa is following the OECD guidelines,¹⁴¹ and are as follows:

- Traditional transactional method, which can use either the comparable uncontrolled price (CUP), the resale price (RP), or the cost plus (CP) methods.
- Profit based method, which uses either the transactional net margin (TNMM) or the profit split methods.

For purposes of this research report these methods are mentioned for guidance purposes, but will not be further discussed due to their intricacies.

135 Greene, C. (2015b), *op.cit.*

136 Retief, E. (2015) *op.cit.*

137 *Ibid.*

138 Taxation Laws Amendment Act No. 22 of 2012.

139 Croome et al., (2013), p.543.

140 Croome et al., (2013), p.544.

141 OECD, (n.d. – g)

Although it is not a current requirement to have a written TP Policy, the South African 2015 Budget Speech¹⁴² contained proposed amendments to the tax legislation to improve TP documentation and reporting. This means that there is a move towards the statutory requirement of having a TP Policy. If this does become legislation then it would have a dramatically negative impact on the costs of compliance for MNEs.¹⁴³

The MNE must note that their TP policy is usually one of the first documents requested and audited by the SARS international tax audit teams. They are focused on these policies because of TP's high BEPS profile in the international tax arena. The key is not only to have a TP policy but also to ensure that the MNE actually implements and follows the provisions of their TP Policy.

During recent SARS international tax audits there has been a trend where SARS has been insisting that MNEs perform comparable exercises every three years to ensure that their TP models are in line with the industry benchmarks, but this begs the question of which database is the most appropriate to use as a benchmark?¹⁴⁴ Interestingly, South Africa does not have its own database, so South African MNEs have to make use of international databases, unfortunately the serious flaw in this is that these databases do not take South Africa influences into account.¹⁴⁵ They are extremely expensive. There is uncertainty as to whether SARS will introduce an advance pricing agreement system (as has been done in other African countries already) which would provide taxpayers some certainty on whether their transactions are acceptable. These advance pricing agreements would allow MNE's to focus on their primary goal of running and growing their businesses without being overburdened by additional administration.¹⁴⁶ A quote made at the South African Institute of Professional Accountants (SAIPA) seminar by the presenter,¹⁴⁷ highlights the frustration most South African MNEs feel towards the guidance SARS offers in terms of TP issues; 'It's like sailing a ship without a proper compass or map, but you better not be found in the wrong territorial waters.'

142 South African Ministry of Finance, (2015)

143 Retief, E. (2015), *op.cit.*

144 *Ibid.*

145 Retief, E. (2015) *op.cit.*

146 Webber Wentzel, (2015), *op.cit.*

147 Retief, E. (2015) *op.cit.*

2.3.11 Withholding Taxes (WT)

WT are final taxes and must be paid over to SARS by the last day of the month following the month in which the payment was made.¹⁴⁸ WTs ensure that non-residents pay taxes on certain income streams, and the imposition of the WT are on these payments made by residents to non-residents. If the resident fails to comply or withholds the incorrect amount of WT, they are personally liable for that WT.¹⁴⁹ There are various types of WTs which are levied, as announced in the South African 2015 Budget Speech¹⁵⁰, are as follows:¹⁵¹

➤ Royalty income

- Calculated at a rate of 15% (before 1 January 2015, it was 12%) on the gross royalty payable to a non-resident, where the royalty is regarded as having been received or accrued to that non-resident from a South African source.
- There is an exemption in section 49D of the Act, where if the property that the royalty relates to is effectively connected to a PE of that non-resident in South Africa. The exemption exists as the PE will be liable for normal income tax.

➤ Dividends¹⁵²

- This is a tax on the beneficial owner of a dividend at the standard rate of 15%, subject to numerous exemptions. These exemptions including dividends paid to South African resident companies and public benefit organisations as beneficial owners and where the dividend is not exempt from income tax in the hands of the recipient.
- In the case of dividends in kind (referred to as *in species* dividends, which are dividends other than in cash) the tax is borne by the company that declares and pays the dividend.

148 Retief, E. (2015) *op.cit.*

149 Olivier, L. and Honiball, M. (2011), *op.cit.*, p.362 – 363

150 South African Ministry of Finance, (2015)

151 Retief, E. (2015) *op.cit.*

152 BDO, (2015)

➤ In disposal of immovable property:

- Broader application of what is meant by this term and the extension of South African law, was envisaged in the South African 2015 Budget speech¹⁵³, it is proposed that the definition of 'immovable property' which is subject to WT be aligned with the definition contained in the OECD's Article 6(2).

This means that it would include; property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.¹⁵⁴

- This WT is in advance of a non-resident's CGT liability that must be withheld by the purchaser in respect of the disposal by a non-resident of immovable property with a value in excess of ZAR2 million. The rates are 5% of the purchase price if the seller is a natural person, 7.5% if the seller is a company and 10% if the seller is a trust. A lower withholding rate than those set out above may be granted on application to SARS.¹⁵⁵

➤ Interest

- WT rate of 15% is now applied to South Africa sourced interest paid to any non-resident (whether connected or not) with effect from 1 March 2015 under section 50 A-H of the Act.¹⁵⁶
- Exclusions:¹⁵⁷
 - Section 50D of the Act, contains WT exemptions, and section 50D(1) of the Act refers to situations where WTs do not apply to interest paid by the 1) Government, 2) South African bank or 3) is paid in respect of listed debt.

153 South African Ministry of Finance, (2015)

154 Webber Wentzel, (2015), *op cit*.

155 BDO, (2015)

156 Retief, E. (2015), *op.cit*.

157 van der Zwan, P. (n.d.).

- Section 50D(3) exemption is available if:
 - The debt in respect of which the interest is paid is effectively connected with a PE of that person in South Africa, if the person is registered as a taxpayer in terms of the Tax Administration Act¹⁵⁸.
 - The last exemption must be read together with section 10(1)(h) of the Act. If the exemption in section 10(1)(h) of the Act does not apply, then it means that the non-resident is not subject to the WT based on its presence in South Africa or the fact that the interest relates to a loan effectively connected to a permanent establishment in South Africa. The interest would be taxed at the normal income tax rates, rather than the withholding tax rates.
 - Deemed date of payment is the earlier of date of payment or date the amount became due and payable.

➤ Cross-border Service fees¹⁵⁹

- Unlike many developing countries, South Africa does not impose WTs on consultancy, management or technical fees, yet.
- With effect from 1 January 2016, it is expected that it will be levied at 15% of the gross amount of the fees paid to the non-resident. These fees will be subject to tax treaty relief as it would result in DT due to gross income in the hands of the recipient and WT on the non-resident payment.

The statutory requirement to WT will impose an administrative burden but possibly also an economic cost on South African MNEs. Although the economic effect may be significantly less where a DTA has been entered into between South Africa and the other state of tax residence¹⁶⁰ WT rates may vary according to DTA's.

¹⁵⁸ Tax Administration Act, No.28 of 2011.

¹⁵⁹ Munnik, K. (2011),

¹⁶⁰ van der Zwan, P. (n.d.), *op.cit.*

2.4 Conclusion

The purpose of this chapter is to address the first sub-problem by enabling knowledgeable determinations, promote and support proper decision making to either enter or continue with cross-border activities in terms of trade and/or investment by the MNE's. With the huge technological strides in information, it is often difficult to know which aspects are important in terms of cross-border activities. This research report is aimed at offering guidance in the form of a birds' eye view of exactly what defines the fine line between success and failure in relation to cross-border activities. As part of a positive business solution the key is the awareness and capability to identify important concepts and terminologies that the MNE's needs to understand and be able to determine, especially regarding issues that could impede or contribute to financial success, such as DT and DNT.

CHAPTER 3. Double Taxation Treaties, Agreements and Conventions – insights

3.1 Introduction

‘Lawful avoidance of tax in any jurisdiction is the realisation of every taxpayers’ dream’ (Huitson, R)

In this chapter, we will discuss aspects of DTA's, which are very useful tax planning tools when it comes to the avoidance of DT. DTAs main objective is to facilitate cross-border activities by eliminating DT issues which could be a major obstacle for MNEs in their quest to expand and grow by creating a global footprint.¹⁶¹ Some of the concepts discussed in Chapter 2 link into DT treaties (also often referred to as DT conventions or DTAs).¹⁶²

A DTA exists when each country has a right to tax and establishes the rules and negotiated terms between the two countries.¹⁶³ The tax treaty is a bilateral agreement or DTA that will determine in which country the MNE is a resident and will be taxed accordingly.¹⁶⁴

The relief that a DTA provides is related to the foreign income on which foreign taxes are paid, which should qualify for a deduction or rebate when included in the South African income. There are two types of relief that can apply, namely, Bilateral/DTA (if applicable) or Unilateral relief. Unilateral relief can either be in the form of a deduction, rebate or exemption.

It must be noted that the original intention of a DTA is to avoid DT, and is not intended to result in DNT.¹⁶⁵

It would be advisable to establish whether there is a DTA in place with the other country, before entering into cross-border activities. This would ensure that the relevant contracts can be set up in relation to the DTA, so that there are no conflicting clauses that could negatively impact the contract. Refer to Appendix B for a summary of all DTAs between South Africa and the rest of the world.

161 Arnold, B. and McIntyre, M. (2002), *op cit.*, p.105; Croome et al., (2013), *op cit.* p.559.

162 Thuronyi, V. (1998), *op.cit.*, p.4

163 Olivier, L. and Honiball, M. (2011), *op cit.* ,p 32

164 Schäfer and Spengel, (2002), *op cit.*

165 Porter, N.(2014), *op cit* ,p 99

3.2 Coverage of tax treaties

Article 1 of the OECD MTC states that; ‘This Convention shall apply to persons who are residents of one or both of the Contracting States’.¹⁶⁶

Included in Article 3 of the OECD MTC¹⁶⁷, there are the definitions, which define the term ‘company’ means anybody corporate or any entity that is treated as a body corporate for tax purposes, the term ‘enterprise’ applies to the carrying on of any business; and the term ‘business’ includes the performance of professional services and of other activities of an independent character.

3.2.1 The relationship of Tax Treaties and Domestic Law

Domestic law does not always incorporate the contents of treaties, however, a DTA is intended to confer enforceable rights on taxpayers against the countries that are parties to the DTA.¹⁶⁸

When it comes to the interpretation of DTA’s it should be according to its ‘context and in light of its objectives and purpose’¹⁶⁹ although the South African Constitution¹⁷⁰ does not oblige a court to interpret the Act in a way that is consistent with the OECD MTC or its commentary.

The issue of whether a DTA outranks the domestic law, in the case of a conflict, is still an ongoing debate. There were some important court cases which reflect the legal climate and their view on this subject:¹⁷¹

- In the case of *C: SARS v Tradehold Ltd*¹⁷² the SCA said;
Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. ... a double tax agreement thus

¹⁶⁶ OECD, (n.d. – g), Article 1

¹⁶⁷ OECD, (n.d. – g),

¹⁶⁸ Thuronyi, V. (1998), *op.cit.*, p.8

¹⁶⁹ United Nations, (1969).

¹⁷⁰ Constitution of the Republic of South Africa Act 108 of 1996

¹⁷¹ Du Plessis, I. (2012)

¹⁷² C:SARS v Tradehold Ltd 2012 (4) SA 184 (SCA)

modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict¹⁷³.

This judgment was made by the SCA so it is likely to be the one to set the precedent for future cases. The effect of this judgment was that it prompted the then Minister of Finance, Mr. Pravin Gordhan to issue a statement the judgment would be reviewed by the Department National Treasury and that, if necessary, it would propose amendments to the tax laws to clarify the meaning of that particular DTA. This shows the seriousness with which the South African government views these judgments, and how the tax laws amendments are sometimes derived at¹⁷⁴.

- In the case of *C: SARS v Van Kets*¹⁷⁵, the court found that the provisions in a DTA, according to Section 231 of the South African Constitution¹⁷⁶, becomes part of South African domestic income tax laws once it has been gazetted¹⁷⁷. Thus the domestic law and a DTA rank equally, 'thus the provisions of a DTA and the Act should, where possible, be reconciled and read as one coherent whole'.¹⁷⁸

3.2.2 Prevention of DTA abuse

A way to prevent DTA abuse is to ensure that tax treaties are standardised or follow , for example, the OECD international standards in respect of their main elements, especially the tax rate limits on interest and royalties and the definition of PE, etc.¹⁷⁹

Anti-avoidance provisions must be included in DTA clauses, such as, usage of a tax haven (refer to point 3.7.1) where MNEs have decided to minimise their tax burden through a tax haven jurisdiction. This leads to problems where governments, individual taxpayers and businesses are all negatively affected ¹⁸⁰

173 King, E. (2015).

174 SAIT, (2012a).

175 C:SARS v Van Kets 2012 (3) SA 399

176 Constitution of the Republic of South Africa Act 108 of 1996

177 South African Gazettes publish the proclamations by the South African President and both general and government notices made by various government departments. It also publishes Regulations and other notices in terms of the various Acts updates and enactments,

178 SAIT, (2012b).

179 Porter, N. (2014), *op.cit.*, p.78

180 OECD, (n.d. – g).; Porter, N. (2014), *op.cit.*, p.95

3.3 Double tax

DT can either be in the form of 'juridical' or 'economic' DT. The difference is that economic DT is when the same income is taxed by two states, in the hands of different taxpayers, whereas juridical DT is the same scenario as the economic DT but the tax is imposed on the same taxpayer.¹⁸¹ DT arises where two states seek to tax the same income due to the different bases of tax being used because, namely: ¹⁸²

- 'source - source' the income was sourced in their respective states;
- 'residence – residence' both states claim the MNE is a resident (the dual residency issue);
- 'residence – source' one state taxes because of residency status, and at the same time the other state taxes because the income was source there.

3.3.1 Relieving DT in residence - residence conflicts

Tie-breaker rules contained on the respective DTAs are extremely important because they resolve the issue of which state is entitled to tax the MNE. There are different types of residency conflicts¹⁸³ and the residence-residence conflicts are where the OECD MTC Article 4¹⁸⁴ states that a dual resident MNE is considered to be a resident of the state in which its POEM is situated. Refer to Chapter 2 for more detail on what POEM means. Paragraph 24 of the Commentary on Article 4¹⁸⁵ states that if there is difficulty in determining the POEM a case-by-case approach can be used.¹⁸⁶

3.3.2 Relieving DT in residence- source conflicts

Another type of residency conflict is residence-source conflict, where usually the DTA will grant the source country the taxing right over the residence country.¹⁸⁷

181 Croome et al., (2013), *op.cit.*, p. 563

182 Arnold, B. and McIntyre, M. (2002), *op.cit.* p.315

183 Croome et al., (2013), *op.cit.* p.564 -565

184 OECD (n.d –g), Article 4

185 *Ibis*

186 Croome et al., (2013), *op.cit.* p.564 -565

187 Arnold, B. and McIntyre, M. (2002), *op.cit.* p 29; Croome et al., (2013), *op.cit.*, p.565

3.4 The OECD DT relief

The OECD recommends that countries should base their individual DTAs on the OECD MTC and follow its Commentaries assisting the countries with the interpretation of the provisions of the MTC.¹⁸⁸ All treaties have a dual nature as it is seen as a bilateral agreement, which is an international agreement entered into between two states, and it actually forms part of domestic legislation.¹⁸⁹

Article 23A or 23B of the OECD MTC¹⁹⁰ deals with the elimination of DT, whereby the limitation is on a country by country basis, although similar to section 6quat of the Act where the limitation is on aggregate foreign income. In a nutshell the country of residence must give a deduction/rebate, whereas the country of source usually gets the tax benefit.¹⁹¹

The two methods of DT relief effectively mean that the state of source usually gets the tax benefit and the state of residence should give a deduction/rebate. The methods are:¹⁹²

1. The exemption method (in Article 23A), which states that income of a resident may be taxed in the other contracting state in terms of the DTA, then the resident state must exempt the same income from tax; whereas
2. The credit method (in Article 23B) uses the same scenario as above but the resident state must allow for a deduction from its own tax equal to the tax paid in that other state.

3.5 South African DT tax relief methods

There are also two methods currently used as a relief from DT in cross-border context is available in terms of domestic law or tax treaty law, or both in South Africa which are:¹⁹³

1. The exemption method provided in section 10, 9D(2A) and 9D(9) of the Act, which exempts certain foreign transactions from tax;

188 OECD, (n.d. – g), para 3

189 *Ibis*.

190 *Ibis*, Article 23

191 Greene, C. (2015b), *op.cit.*, p.23

192 Croome et al., (2013), *op.cit.* p. 569; Greene, C. (2015b), *op.cit.*, p.116

193 Greene, C. (2015b), *ibis*.

2. The credit method is in rebate form regarding foreign taxes on income, known as a section 6quat rebate. In summary the rebate has the following characteristics: it is applicable to foreign sourced income where foreign tax is paid on the foreign source income that may be offset against South African taxes raised on the respective income; is limited to South African tax levied on respective income so it must be subject to South African tax; all foreign sourced income is pooled together and the excess tax amount can be carried forward for seven years¹⁹⁴.

A common calculation which is done incorrectly is the section 6quat calculation, so here is a simple example to illustrate the mechanics¹⁹⁵ of section 6quat of the Act, on foreign sourced income:

South Africa income		1 600 000
Foreign income (a)		400 000
Taxable Income (b)		2 000 000
South Africa Tax at 28% (c)		560 000
Less section 6quat rebate:		
Foreign tax paid	120 000	
Limited to: South African Tax on respective income		
400 000/2 000 000 x 560 000 (a/b x c)	112 000	(112 000)
Final total South Africa Tax payable		448 000

In terms of IFRS, the MNE is able to recognize a deferred tax asset on the unused section 6quat rebate portion¹⁹⁶, but must only be recognized to the extent that it is probable that the unused section 6quat rebate will be utilised by the company prior to the seven year period ending¹⁹⁷.

In terms of a DTA, it must be noted that a MNE can elect to claim either a section 6quat rebate or claim relief under the DTA, but may not claim both.¹⁹⁸

194 Musviba, N. (2014b)

195 Greene, C. (2015b) ,*op.cit.*, p.116

196 IFRS, (2012), p.2.

197 South African Tax Guide, (n.d.)

198 Croome et al., (2013), *op.cit.*, p.568

The deduction method which was provided by section 6quin of the Act, has been repealed in the South African 2015 Budget Speech.¹⁹⁹ This section made a credit available for foreign taxes incurred on management services rendered in South Africa, but it extremely burdensome on SARS as they were responsible for the collection of foreign tax that is incorrectly withheld by a foreign state. Now the MNE will only be entitled to claim a tax deduction (it is not a credit) for tax, which is correctly withheld in respect of amounts relating to services rendered in South Africa.²⁰⁰

3.6 Treaty distributive rules

In the OECD MTC there are distributive rules which relate to the following typical types of income flows that are covered by DTA's, and to provide some clarity the following will be elaborated on briefly:²⁰¹

➤ Business Profits (Article 7)

Business profits that a resident earns from a foreign country, a DTA will provide relief in the foreign country unless the profits are attributable to a PE where it will then be taxed in the foreign country. Usually the business profits may be taxed in both states, but the MNE can seek relief in terms of section 6quat or a specific article in terms of the DTA.

➤ Interest and Royalties (Article 11 and 12 respectively)

In terms of an applicable DTA, any royalties paid by a resident of a foreign country to a resident who is the beneficial owner of the royalties may either only be taxed in one or in both countries. If in both countries, a cap may be applied to the maximum tax rate that the countries can apply. If the resident carries on a business in the foreign country through a PE and the right or property which gives rise to the royalties is connected with that PE, then the provisions governing business profits, as mentioned above, will apply.²⁰² The same rules apply to interest.

199 Retief, E. (2015) *op.cit.*; South African Ministry of Finance, (2015)

200 Webber Wentzel, (2015), *op.cit.*

201 Greene, C. (2015c), *op.cit.*

202 *Ibis*.

➤ Service Fees²⁰³

Most DTAs which have been concluded with African countries permit the foreign state to impose a WT on the payment of technical fees or management services even if the resident does not have a PE in that country. If a PE does exist, the business profits article will usually govern.

➤ Dividends (usually Article 10)

There is a specific definition, which excludes debt instruments. Where dividends are paid by a non-resident to a resident (who is the beneficial owner of the dividends) it may generally be taxed in both countries. Notably the term ‘beneficial owner’ is not defined but it is assumed that it is the one that who has the discretion to decide what to do with the funds.

There is a cap that is often applied to the rate which the foreign country may apply in instances where the resident holds a significant interest in the non-resident.²⁰⁴ If the resident carries on business in the foreign country through a PE, the business profits provisions²⁰⁵ will apply.

➤ Capital Gains (Article 13)

This means that gains on business assets are generally sourced at the place of the PE to which the gain is attributable, so gains on immovable property are sourced where the property is situated and gains on movable property are sourced where the MNE disposing of it is resident. Thus, so in both instances the gains can be may be taxed in the other states.²⁰⁶

²⁰³ *Ibis*.

²⁰⁴ *Ibis*.

²⁰⁵ Refer to the first bullet of this point 3.6 Business Profits

²⁰⁶ OECD (n.d –g), Article 13, pp. 32 - 33

➤ Income from Immovable Property (Article 6)

This applies to income derived from the direct use, letting, or use in any other form (rights, usufruct, etc.) of immovable property. It may be taxed in both states but there is relief in terms of section 6quat rebate or a specific article in terms of the DTA.

➤ Employment, Services, and Pension Income (Articles 15, 16, 18, 19 and 20)

These types of income have different considerations that require a further look into the exact circumstance of where the income is earned, but for this research report purpose a brief high level summary is that a resident MNE may have certain withholding obligations in the foreign state where it sets up operations, if it employs individuals in those countries or second individuals from its resident state for example, South Africans are brought in to work in the foreign country.

If the employees are South African tax residents and a DTA is applicable, the employee may escape the tax liability in the foreign country. For this to occur the DTA requirements would typically be the following:²⁰⁷

- The employee must not be in the foreign state for a period exceeding in aggregate 183 days in any consecutive twelve month period;
- The remuneration must be paid by the MNE which is not a resident of the foreign state; and
- The remuneration must not be borne by a PE which the MNE has in the foreign state.

➤ Transportation : Shipping, inland waterways and air (usually Article 10) ²⁰⁸

Profits generated from the operation of aircraft or ships are taxable in that state.

²⁰⁷ Greene, C. (2015c). *op.cit.*
²⁰⁸ Croome et al., (2013), *op.cit.* p.572

➤ Other income (Article 21)

This will only be taxed in the state of residency, unless it is connected to a PE (then refer to article 7)

3.7 Some Tax Avoidance / BEPS Techniques

These are classically associated to BEPS, and refer to concepts such as, treaty shopping double-dipping and tax havens, which erode the various tax bases. In effect they lead to the side-stepping or greatly reducing an anticipated tax liability in both the source and residence states. Sometimes they unjustly benefit MNEs by taking advantage of loop holes in the DTA or domestic tax law in order to claim DT deductions. It is often in these areas that there is a great deal of sophisticated international tax planning done which is clearly the basis for tax avoidance. The tax authorities are extremely suspicious of MNEs which engage in any of these techniques, so caution must be taken with all cross-border activities which involve any of the following.

3.7.1 Utilisation of tax havens

The OECD states that a tax haven is;

... in the "classical" sense refers to a country which imposes a low or no tax, and is used by corporations to avoid tax which otherwise would be payable in a high-tax country. According to OECD report, tax havens have the following key characteristics; No or only nominal taxes; Lack of effective exchange of information; Lack of transparency in the operation of the legislative, legal or administrative provision.²⁰⁹

A major characteristic is their high levels of secrecy in banking and commercial sectors. Tax havens achieve BEPS through reducing the effective tax rate applicable in a jurisdiction to nil or a minimal rate. Often they also do not have any TP legislation.²¹⁰ This is a popular area where MNEs activity perform aggressive tax planning to simultaneously to reducing

²⁰⁹ OECD, (n.d.- g).

²¹⁰ Porter, N. (2014), *op.cit.*, p. 93

source country and residence country tax, by shifting their profits to two or three countries, with the overall result is payment of little or no tax in the source or resident country.²¹¹

3.7.2 Double-Dipping

This technique is used by dual resident MNEs to deduct the same expenses in two tax jurisdictions, by exploiting differences in the different tax treatments of the same expense.²¹² The effect is in essence the doubling up on favourable tax rules in both source and resident countries.

A common area of abuse is a financial lease on equipment, where in one jurisdiction it would be treated in the same way as an operating lease. The owner is entitled to depreciation and interest deductions, and the lessee rent transactions. In the other state this same lease might be re-characterised for tax purposes as purchases and loans. It is possible that two different taxpayers could be treated as the owner of the equipment in different countries and each would be entitled to the same incentives in one of the countries, effectively doubling up on the incentives and this was not intention by either state.²¹³

The issue is clearly the offsetting of the same deductions against different income of different taxpayers. If the deduction of the same expense was offset against the same income that each state was taxing, it would not be an issue as the residence state would offer DT relief.

Double-dipping is often ambiguous as it is not clearly identifiable that tax avoidance was the sole purpose of the advantage, and it is difficult to say which of the states is disadvantaged by this unfair reduction in tax. This practice is likely to continue to be an issue in respect of international tax, without an easy practical solution.²¹⁴

3.7.3 Treaty Shopping

The OECD defines this as;

²¹¹ Thuronyi, V. (1998), *op.cit.*, p.72

²¹² OECD, (n.d.- g).

²¹³ Thuronyi, V. (1998), *op.cit.*, p.73

²¹⁴ Porter, N. (2014), *op.cit.* p.75

An analysis of tax treaty provisions to structure an international transaction or operation so as to take advantage of a particular tax treaty. The term is normally applied to a situation where a person not resident of either the treaty countries establishes an entity in one of the treaty countries in order to obtain treaty benefits.²¹⁵

Tax treaties can become the object of tax avoidance activities, as many MNEs could abuse the treaty's provisions. In reality, bilateral tax treaties has often resulted in a DNT.²¹⁶

3.8 Tax Treaty Issues Not Covered in Domestic Law

The key issues which DTA's cover, but might not be catered for in domestic tax law are as follows:²¹⁷

➤ Non-discrimination:

This feature is to ensure that there is no discrimination by that country's tax system, against the foreign investors compared with domestic investors.

➤ Exchange of Information and Assistance in Collection

Although most countries have a domestic law rule that they will not directly or indirectly assist another country in the collection of its taxes, the exchange-of-information provisions are found in virtually all tax treaties which has the intention of preventing fiscal evasion. This primarily refers to cases where MNEs fraudulently conceal income in an international setting and rely on the inability of tax administrations to obtain information from abroad.

The exchange of information article in tax treaties is the major provision dealing with this problem.²¹⁸ In a recent court case, *C:SARS v Mark Krok*²¹⁹, this provision of a DTA was used successfully by the Australian Commissioner, whereby the tax collection recovery was done by SARS on behalf of Australia under the Protocol to the Australia/South Africa DTA. SARS successfully obtained a final preservation order over the assets of the taxpayer who owed the Australian Tax Office well over ZAR200 million.

215 OECD, (n.d. - g).

216 United Nations Conference on Trade and Development, (2014).

217 Porter, N. (2014), *op.cit.* p.80

218 Thuronyi, V. (1998), *op.cit.*, p.8

219 *C:SARS v Mark Krok* (HC 1319/2013 NG)

➤ Mutual Agreement Procedure

This is usually the final provision in a DTA which requires comment is the article on the mutual agreement procedure. This article provides for a dispute resolution mechanism for the application of the provisions of the DTA to specific cases, and allows the states to agree on common interpretations and applications of their DTA, and finally it allows for resolution in situations where DT is not otherwise dealt with by their DTA.²²⁰

3.9 Conclusion

The purpose of this chapter is to address the second and third sub-problems. If the whole area of DTA is understood, it can be used as a tool against DT. The role of a DTA is to assist with anti-avoidance initiatives, which serves the objective of preventing the erosion of tax bases of the various tax jurisdictions.

The ability to eliminate DT is a necessity if the global taxing authorities want to ensure the security of their domestic tax base. This will lead to creating a more attractive investment opportunity for MNEs without increasing the burden on the small pool of other taxpayers. The creativity of avoidance schemes are often complicated and provide some relief for those dual resident MNEs who suffer under DT impositions. This often results in serious BEPS, resentment and exploitation which could contribute to restrictions on foreign-owned operations. Unfortunately this could also lead to restrictions in terms of the inflow of foreign capital, technology, and management skills which are ever-increasing requirements to ensure domestic growth in an ailing global economy.

220 Porter, N. (2014), *op.cit.*, p.86

CHAPTER 4. An overview of critical underlying cross-border issues.

4.1 Introduction

'Today knowledge has power. It controls access to opportunity and advancement.'

- Peter Drucker

There are numerous critical issues, risks and factors for MNEs to be cognisant of when considering international trade, investment and/or expansion of operations globally. In an effort to mitigate these associated issues, risks and factors related to this international movement, it is imperative that the business team includes an expert in the field of international tax.

Various tax issues require in-depth consideration and planning, which all culminate in the central issue of avoiding DT and complying various tax jurisdictional legislation. The key essential is that the MNE must be positioned to see the cross-border activity in its entirety. As well as, be capable of considering all applicable taxes which could be levied, as well as other statutory requirements which would have a negative impact if not adhered to.

4.2 Important business strategy tools

4.2.1 Tax Intelligence (TI) for MNEs.

Business intelligence (BI) is an important tool in business strategy. As the term implies that it is essential to have a comprehensive knowledge of all of the factors that affect the business.²²¹ In the same vein, an apt sub-section of BI would be TI. Although I have not been able to find this term in any of the research material that I have reviewed over the course of this research, I think that it is appropriate for MNEs to include tax intelligence in their business strategy. It supports the objective of BI which as stated in the Journal of Theoretical and Applied Information Technology, is to:

²²¹ Ranjan, J. (2005), p.60

...enable organisations to make well informed business decisions and thus can be the source of competitive advantages.... Once business intelligence is gathered effectively and used proactively then the firms can make decisions that benefit the firms.... Timely and good quality information is like having a crystal ball that can give an indication of what's the best course to take.²²²

TI applicable to MNEs should investigate and carefully considered all relevant current information, legislation, statutory requirements prior to any cross-border activity. In addition to the information already discussed in the previous chapters of this research report, there are a few which are worthy of highlighting, in brief. It is important to note that this research report is not exhaustive and the following information is an emphasis on key TI's.

➤ Revenue authorities monitoring and enforcement of compliance:

SARS has a dedicated department in this respect namely, the Revenue, Risk and Intelligence (RR&I) department. It has 4 main structures under it, i.e. Revenue Analysis and Forecasting, Compliance Risk, Intelligence, and Projects.²²³

➤ Revenue authorities key focus areas which impact on MNEs:

The tax avoidance concepts which were stated in Chapters 2 and 3 of this research report, are the key focus areas that are under scrutiny, such as:

- TP, which is viewed as a huge risk of BEPS which negatively impacts the South African tax base. An important development is that SARS is considering the implementation of Advance Pricing Arrangements (APAs). The advantage of these APAs are that MNEs can engage with SARS prior to entering into transactions to agree on the pricing arrangements. A positive step for limiting risk in terms of transfer pricing adjustments and the potential of DT risks.²²⁴

Compliance risk is on the fore front of which it comes to irregular tax claims or exemptions and is applicable to multiple taxes.

²²² Ibid.

²²³ SARS, (n.d.- e).

²²⁴ Ibid.

Taxing authorities are successfully and efficiently gathering all types of relevant information from various sources. This information gathering assists with the identification of compliance risks.²²⁵

4.2.2 International tax professionals

To ensure proper tax planning and advice is obtained by way of an international tax professional, as a starting point when considering any cross-border activities.²²⁶ They can assist with tax issues such as: what the specific tax considerations are. Important aspects of how the tax legislation, of both the domestic and foreign states, will impact on the cross-border activity must be considered, such as: ²²⁷

- Is there any conflicting legislation between the two states?
- What are the compliance requirements of both the domestic and foreign states which will impact on the cross-border activity?
- What are the possible consequences of not registering at all or in time, or non-compliance, with regards to penalties and legal action?
- Where are the areas where DT could be levied?
- What are the DTA's that are available and what are their advantages and disadvantages?
- Which are the focus areas or key projects of the taxing authorities? For example the SARS current projects include TP and high net worth Individuals.²²⁸
- Are the tax compliance requirements met by the MNE?
 - Are the business operations correctly accounted for regarding the revenue authority's tax requirements?

²²⁵ *Ibid.*

²²⁶ Munnik, K. (2011). *Op cit* p.17

²²⁷ Webber Wentzel, (2014).

²²⁸ SARS, (n.d. - e).

- Are all the compliance statutory requirements being achieved/achievable?
- What are the administrative procedures of the various types of taxes, for example, registration, due dates and exactly what documentation support tax disclosure and declarations?
- What are the anticipated tax amendments which could negatively impact any cross-border activities?
- Which WT are required, refer to Chapter 2.
- Advice on tax structuring cross-border issues such as: financing, operating and treasury functions, mergers and acquisitions, trading operations, investments, usage of offshore trusts, contracts.
- What are the exchange control requirements and impact on cross-border activities? Refer to Chapter 2.
- What are the other factors which can have an impact on these activities, such as how does the accounting treatment compare to the required tax treatment for company tax returns?

4.2.3 Management of taxes

There are numerous taxes which can be levied on MNEs, in both the indirect and direct categories, which require attention:

- Any one or several of the following could be levied: VAT or General Sales Tax (GST), customs taxes and excise duties, employment taxes, ad valorem taxes, capital gains taxes, corporate taxes, withholding taxes, CFC's, section 6quat rebates, foreign taxes, TP adjustments, use of tax assessed losses and the avoidance of DT, social grant taxes, state and federal taxes.

- To illustrate the complexity of the compliance issues related to a tax type it is advisable to consider the tax practitioner as a valuable asset, and it is critical that the MNE should also fully understands issues such as:²²⁹
 - In respect of VAT – what are the VAT rules in both states; what amounts of VAT can be levied, what are the thresholds (if any) for VAT registration; when are the VAT returns filed – on what basis, for example, monthly and by when must it be filed? What are the various treatments of VAT regarding residents and non-residents? What constitutes a supply of goods? Are there different VAT ratings and if so what are the documentary requirements of each VAT rating. What are the time of supply rules?
 - In respect of customs duties, what costs are deductible, as each country's duties differs from each other. Are there any considerations that could be used for tax savings, for example, will there be a lower customs value placed on assembled or dis-assembled items? In South Africa there are no customs duties on exports but SARS does track exactly what is leaving the country by way of the SARS foreign exchange disclosures, the Customs Declaration Form (SAD 500)²³⁰, and through VAT returns.

Countries have different requirements regarding their customs declarations, in respect of value South Africa uses FOB²³¹ (Free on Board) to the place of dispatch. This is not to be confused with the Inco Term FOB, as this is a SARS Customs term. When comparing the two terms, it is advisable to note that the Inco Term FOB²³² relates to the seller's responsibility for ensuring the goods are transported from the plant to the vessel, and the risk will transfer to the customer when the goods pass the ship's rail. The SARS Customs FOB term²³³ relates to the customs value;

The 'free on board' price forms the basis for the value, but allows for certain deductions (such as interest charged on extended payment terms) and additions (such as certain royalties).

²²⁹ Greene, C. (2015b), *op.cit.*, p.74

²³⁰ The SAD 500 is a SA Customs form which is required when exporting goods to ensure proper declarations are made; Exporthelp, (n.d.)

²³¹ Retief, E. (2015) *op.cit.*

²³² Mzizi, S. (2015)

²³³ SARS, (n.d. - f).

It is advisable to investigate whether there are Preferred Trader Schemes²³⁴ offered by the Customs Department, which could benefit cross-border trade if certain requirements are met? These schemes provide the accredited trader, certain advantages and benefits, such as²³⁵:

- The appointment of a Customs Relationship Manager tasked with facilitating the relationship between the client and Customs
 - Reduction of the amount of security required for compliance with a Customs procedure
 - Fewer routine documentary and physical inspections
 - Prioritising a request for tariff and valuation determinations
 - Prioritising access to non-intrusive inspection techniques when goods are stopped or detained for inspection.
- Non-tax factors also require investigation, but for this research report they will not be dealt with in depth. For awareness purposes, issues in the other state which could have an adverse impact on any cross-border activity could include: political stability, human rights issues, credit rating of the country or major businesses, any counter trade obligations or requirements.²³⁶

4.2.4 Expansion structure²³⁷

The question is which structure is the most tax efficient? Will it be in the form of an IHC, subsidiary, PE, division or branch or will an agent be made use of? The significance of this decision will affect the amount of tax to be paid (both domestic and foreign), as well as the foreign tax payable will qualify for any domestic unilateral relief in the form of a DTA, deduction or rebate.

²³⁴ SARS (n.d.- a)

²³⁵ *Ibis*

²³⁶ Retief, E. (2015) *op.cit.*

²³⁷ Greene, C. (2015a), *op cit*, p.3

4.2.4.1 Subsidiary

- Where a foreign subsidiary is chosen it will have access to the DTA network and tax regime of the foreign country.
- Positive consequences of using a subsidiary:
 - Constitutes a separate and independent legal entity;
 - Legal liability exists in the subsidiary.
- Negative consequences of using a subsidiary:
 - Transfer Pricing issues;
 - Risk of possible loss of control. In some states, especially African states, there is a requirement that if a foreign subsidiary is formed in their country that a percentage of the ownership be handed over to their government, or their indigenous people;
 - Statutory compliance requirements;
 - Taxed on their world-wide income;
 - Dividends are usually taxed on the distribution of profits to the parent company.

4.2.4.2 PE

Refer to Chapter 2, point 2.2.9.

4.2.4.3 Division or branch

➤ Positive consequences:

- Taxed on source of income;
- No dividend taxes are applicable;
- Losses are ring-fenced in the country that it arose in;
- Set up and closure costs, and administration are less expensive and less onerous.

➤ Negative consequences:

Legal liability remains with the MNE.

4.2.4.4 Agent

➤ Positive consequences:

- Independent agent (no tax issues for the MNE, in respect of the agent);
 - OECD Commentary²³⁸ reveals that an agent will only be regarded as independent of the principal if it²³⁹ enjoys legal and economic independence;
 - An agent will be regarded as being economically independent only to the extent that s/he or it carries on comprehensive economic activities of its own.

²³⁸ OECD, (n.d. – g), Article 5

²³⁹ In terms of an agent – 'It' refers to either s/he or it, whereby the agent could be an individual or a company/legal entity

➤ Negative consequences:

- Dependant agent²⁴⁰ (tax issues arise if it performs work solely for or is controlled by the MNE):
 - There is a distinction between economic and legal dependence;
 - An example of legal dependence, is where an agent contractually undertakes to spend the majority of its time on the business of the principal;
 - Where the agent's commercial activities are subject to detailed instructions or to comprehensive control by the principal, such agent cannot be regarded as being independent;
 - If carry on activities mainly on behalf of one principal, the agent may be regarded as being economically dependent on the principal, since its main source of income will be dependent on the principal.

➤ Other agent consideration:

Contractual obligations must be recorded and responsibilities must be unambiguous up front.

4.2.5 Other considerations in terms of cross-border expansion

4.2.5.1 Tax review committees established by the state

From the South African perspective, a look into The Davis Tax Commission (DTC) is advisable:

When the then South African Minister of Finance, Mr Pravin Gordhan, tabled the South African 2013/14 Budget, he announced that there would be an establishment of a tax review committee: '...to assess our tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability'.²⁴¹

²⁴⁰ OECD, (n.d. – g), *op cit*.

²⁴¹ Taxcom, (n.d.).

This committee is known as the DTC²⁴², and is chaired by Judge Dennis Davis²⁴³. The DTC submits interim and final reports to the Minister of Finance, after it consults with various stakeholders. They have specific terms of reference (TOR) which requires the committee to prepare recommendations and present them to the Minister of Finance. The Minister then considers them and if he agrees, he will take the process forward to convert the recommendations into tax proposals. These proposals are then subject to consultation and Parliamentary oversight.²⁴⁴

The DTC evaluates the South African tax system compared to international tax trends, principles and practices. It also focuses on current international initiatives to improve tax compliance and deal with tax base erosion and profit shifting, like the BEPS Action Plan²⁴⁵ by OECD and the Group of Twenty (G20) bodies.²⁴⁶ An important tax policy objectives of the South African tax system is to strive for an internationally 'competitive tax system'.

In their TOR, there is a particular reference which is of importance for MNEs:²⁴⁷

A review of the corporate tax system with special reference to:

- the efficiency of the corporate income tax structure;
- tax avoidance (e.g. base erosion, income splitting and profit shifting, including the tax bias in favour of debt financing);
- tax incentives to promote developmental objectives; and
- average (and marginal) effective corporate income tax rates in the various sectors of the economy.

²⁴² *Ibis*.

²⁴³ Mazansky, E. (2015)

²⁴⁴ Taxcom, (n.d.).

²⁴⁵ OECD, (n.d. – b)

²²⁶ Taxcom, (n.d.). , *op cit*.

²⁴⁷ *Ibis*

4.2.5.2 Recent court cases

There has been great strides made in South Africa between 2014 and 2015, regarding tax aspects and applicable law decisions or outcomes which will set a precedence that will make this field dynamic and cutting-edge.

Background:

In terms of the tax legal issues, South Africa has four relevant courts²⁴⁸, which are: the Tax Court, the High Court, the Supreme Court of Appeal (SCA) and the Constitutional Court, notably this is in order of authority from lowest to highest. If a taxpayer wishes to institute legal proceedings against the C: SARS, after an unsuccessful dispute resolution process with SARS, they can follow the process through the various courts.

The MNE must be mindful that there are specific requirements applicable as to which court will hear which matters. Therefore it is imperative that the MNE seeks professional and legal assistance in determining the correct legal avenue to proceed with, prior to the commencement of the legal proceedings.

Some of the cases which would be of interest to a MNE, are briefly discussed below, together with some background to promote context:

- In the matter of *Medox Limited v C: SARS*²⁴⁹, the crux of the case was whether the High Court has the necessary jurisdiction to rule on the legal status of income tax assessments. It is clear that this judgment shows that the parties must exhaust all internal remedies before approaching the High Court and are discouraged from 'forum shopping', because it would not have been the legislature's intention to create opposing and parallel forums for the resolution of tax disputes.²⁵⁰
- A fundamental case which has finally clarified the manner in which legislation should be interpreted and the context of the meaning of simulation, is the judgment of the SCA, dated 19 November 2014, in the matter of *C: SARS v*

248 SARS, (n.d.- b).

249 *Medox Limited v C: SARS* (49017/11) [2014] ZAGPPHC 98

250 Paulsen, N. (2014)

*Bosch*²⁵¹. In brief the outcome is that purposeful interpretation takes preference over the literal, as explained;

This is entirely consistent with the approach to statutory interpretation that examines the words in context and seeks to determine the meaning that should reasonably be placed upon those words. The conduct of those who administer the legislation provides clear evidence of how reasonable persons in their position would understand and construe the provision.²⁵²

This case therefore provided a clarification of the meaning of simulation which was previously raised in the case of *South African Revenue Service v NWK Ltd 2011*²⁵³, which was determined to be where the true nature of a transaction is in disguise, as was stated; 'If the purpose of the transaction is only to achieve an object that allows the evasion of tax...then it will be regarded as simulated'.²⁵⁴

- The Ackermans²⁵⁵ case was a landmark case where both the Act and the Promotion of Administrative Justice Act²⁵⁶, was involved. In summary, this case dealt with the issue of prescription and if a taxpayer does not make full/proper disclosure of their tax matters then they cannot rely on the provisions of prescription, and it will fall away and thus SARS will be entitled to re-open any period where this has occurred.²⁵⁷

For more current and detailed information on the specific court cases which have been decided on and judgment has been passed in the various tiers of the courts, please go to the official SARS website²⁵⁸.

251 C:SARS v Bosch 75 SATC 1 (SCA)

252 *Ibis*, para 17

253 *South African Revenue Service v NWK Ltd 2011* (2) SA 67 (SCA) para 55

254 *Ibis*, para 55

255 *Ackermans Limited v C:SARS - HG 16408-2013 NG*

256 The Promotion of Administrative Justice Act 3 of 2000.

257 Retief, E. (2015) *op.cit.*; SARS, (n.d. - d).

258 SARS, (n.d. – b)

4.3 Practical Aid

In a bid to add value and give practical guidance to embattled or uncertain MNEs, Appendix C has an extremely useful checklist, which can be used as a general guide when a MNE is considering or intending to enter into cross-border activities.²⁵⁹

4.4 Conclusion

There are a number of specific considerations that the MNE must consider regarding cross-border activities, whether it is in terms of cross-border expansion or investment. In summary and to present bird's eye view, it is worth re-iterating these considerations: ²⁶⁰

- What are the CFC rules governing activities through a foreign subsidiary?
- What are the types of income flows which will be involved in the cross-border activities?
- What exchange controls are applicable, in both transacting states?
- Which type of structure should the cross-border activities be conducted through, either an agent, branch, PE or subsidiary?
- What is the duration and extent of the cross-border activities to be undertaken by the MNE?
- Which employees will be used for the cross-border activity, foreign or domestic employees?
- What are the residence issues, and how can the status of dual residency be avoided or mitigated if no DTA exists?

²⁵⁹ Greene, C. (2015c), *op cit.*

²⁶⁰ Greene, C. (2015a), *op cit.* p.3

- If there is a DTA in place, then investigate what are the terms of the DTA?
- Is the MNE tax department competent in cross-border transactions and international tax issues such as DTA's, or should an international tax expert be engaged to assist?
- How are the foreign tax rebates or deductions calculated, in respect of both states?

The objective of the MNE is to be globally competitive, but yet it is vulnerable to the enormity of international tax implications. These implications could be the determinate of the success or failure of its' cross-border activities, thus paving the way for the future one way or the other. In our modern, connected global tax climate, tax is continually developing, advancing in the fight against tax corruption, fraud and evasion. There is also a move towards greater transparency and disclosure, therefore there will intensified pressure from the global tax community to increase the scrutiny of MNEs engaging in cross-border transactions and structures. This research report should provide various insights into the imperatives that are essential to increase the relevant knowledge and understanding of the associated tax issues of cross-border activities, which addresses the problem statements mentioned in Chapter 1, and in particular the third and the forth sub-problems.

CHAPTER 5. Conclusion

‘Real knowledge is to know the extent of one’s own ignorance’ – Confucius

The weak current global economy is still stifled and shaken, and is recovering from markets collapsing with weak growth trends in many countries. The overall perception of MNEs is one of goliath financial bullies, which take advantage of aggressive tax planning and involvement in tax evasion methods, as they build profits and are dominant over domestic companies. Drastic measures must be employed to revert this perception so that MNEs are seen not as a threat, but rather a necessity to bring the world economies back onto solid ground

This research report highlights that there are many contentious areas of international tax, which practically affect MNEs. Sometimes the inaccessibility to proper knowledge, the requirement for the simplification of complex concepts or the lack of understanding the tax jargon are the pivotal factors which negatively impact the success of the cross-border activities.

Cross-border activities are in itself a risky and uncertain venture. The MNEs should work together with industry and governments to achieve an efficient but still attractive international tax framework in order to promote and support the success of these cross-border activities, which inevitably will cascade enormous benefits and growth of domestic markets, for all the relevant stakeholders.

The basis to ensuring MNEs tax compliance and encourage further international investment is to provide consistent, clear and unambiguous guidance for international tax issues. Problem areas must have favourable and easily understood resolutions, and a conducive compliance friendly environment. If the MNE is supported and is willing to work with the tax community, the resulting effort could ensure that tax avoidance and unethical behaviour are issues of the past. These efforts might enviably lead to a tax era where businesses can concentrate on the actual business of generating profits, and have less of a burden in terms of tax complications. Subsequently these actions should lead to an increase in support by MNEs towards social investment to uplift struggling communities and mutually beneficial economic success for both the MNE and the countries that they operate with.

In Chapter 2, the objective was to prevent the “ostrich approach” where MNE executives bury their heads in the proverbial tax sand, and choose to ignore international tax issues because they do not understand the important tax concepts and terminologies.

The solution to this often neglected area of critical importance and the real imperative which is fundamental to these practical challenges regularly experienced by MNEs, is to know your business's true tax and business limitations. Only once these limitations are known can the MNE propel itself and its stakeholders into an era of real advancement in growth, exponential expansion of expertise and knowledge, and ultimately contribute to successfully conquering the cross-border frontiers.

Gone are the days where tax issues are solely the tax practitioners' problem. With international focus on best practices and good corporate governance, it is expected that the directors and management tiers of a MNE are fully integrated and well versed in all business processes. This fiduciary duty includes the important area of tax. Audit and risk committees are already assessing tax risk regularly, as this is a usual standard agenda item.²⁶¹

Many experts say that the residency status of a taxpayer is one of the cornerstones of international tax, and I agree strongly. In Chapter 3, the solution to dual residency is to negotiate or establish more tax treaties with more countries, so that the economic effect may be significantly less where a DTA has been entered into between trading states. The ultimate remedy would be to have multilateral treaties, between multiple countries, which would contribute to resolving overlapping issues and eliminating tax avoidance practices more effectively. The move to global interaction and synergies of governments and tax authorities to provide clear international tax solutions must continue. The approaches used by revenue authorities to combat the aggressive tax planning strategies of MNEs, that exploit gaps and loopholes of the current system to artificially shift profits to locations, must be perpetually modernised and reviewed to level the playing field in the area of tax leakages. Achievement in these areas would lead to an improvement in revenue collections instead of the current state of tax mayhem which reveals that despite rising corporate profits, the corporate taxes collected have been falling.²⁶²

In the South African tax landscape MNEs also experience contrasting approaches, for example the SARS and the provisions of the OECD MTC, to residency determination which can cause confusion and possible non-compliance causing monetary losses for these MNEs. The SARS IN6 ²⁶³ is long overdue for a revision, although there is currently a discussion paper released for public comment. It will be of the utmost importance that the POEM provision fulfils its purpose as a substantive test that is not open to "simple, formalistic manipulation". Both international and

²⁶¹ KPMG, (2009)

²⁶² Hungerford, T. (2014), p.7

²⁶³ South African Revenue Services, (2002).

local authorities have come to realisation that a broad-centric approach does not meet the challenges in today's world, this was recognised by the OECD in 2008, when it deleted any reference to an entity's "board of directors" or similar body in the Commentary on Article 4 of the OECD MTC.²⁶⁴

A possible solution would be to agree upon, implement, follow and enforce a universal international tax standards framework that can be incorporated in domestic tax legislation. This solution is extremely ambitious and some might think fanciful, but the accounting fraternity has successfully moved to the adoption of IFRS in the majority of countries, so it is conceivable that this could work for the international tax fraternity. The major hurdle for this solution is the added complication of the corresponding domestic legal fraternity and their co-operation, and involvement, but nevertheless a valid proposal.

In Chapter 4, the conclusion reached is that an insight into the critical underlying issues and factors that a MNE must be cognisant of when considering international trade, investment and/or expansion of operations globally, is imperative. The cross-border activity must be looked at as a whole and serious consideration of all aspects i.e. tax and non-tax issues must be performed. A due diligence tax exercise on the cross-border activity must be performed on all cross-border activities. It is critical that the 'big picture' is taken into account to ascertain which benefits could be enjoyed, which avenues are available to assist with the elimination of DT, conceptualise various business and tax considerations for a MNE which is contemplating this type of expansion conundrum. The time invested in this effort will provide a value-added service to the MNE as a whole, and in the long term may possibly even save money by avoiding undesirable financial losses from incorrect tax interpretation in the form of penalties or missed reduction in taxes through DTA's.

Both sides of the tax coin give a sense of awe towards the tax landscape, where its complexity, interpretation and knowledge are key decision making tools, which can result in major failure or success of a business venture. The negative result emanating from this issue are not only the actual cash outflow result from the DT imposition, but also the tax leakage for the countries involved. It is unlikely that MNEs would be comfortable with the reputation or stigma associated with being seen as a rogue business partner who is a high risk due to non-tax compliance which could adversely impact the business relationship.

²⁶⁴ South African Revenue Service, (2011 - b).

Of course, there is a positive side, which is if an accurate determination and interpretation of the key tax issues are made, this will provide numerous advantages towards continued business success namely, the elimination of DT by ascertaining which (if any) treaty benefits the MNE would be entitled to, and exactly which income would be taxable in which jurisdiction. A useful recommendation that can be offered to assist with these issues, and simultaneously promote transparency and good trade relations, would be to statutorily require all MNEs to provide full disclosure of their global tax positions to tax jurisdictions. The full disclosure would have to be accompanied by the proper enforcement of the revenue authorities' secrecy provisions to ensure the MNEs competitive marketing and business intelligence information and advantages are maintained.

Other issues which could serve as future research areas, include:

- DTA Protocols;
- DNT, greater research into exactly where the overlaps lie, and how to close these loopholes;
- DTA language translations which impact on the revenue authority's interpretation of them and the related tax implications.

The decision to enter into cross-border activities can be overwhelming, and is difficult for MNE's to ascertain exactly what tax implications would be imposed or what mitigation factors are available, thus this chapter endeavors to promote a paradigm shift into the exciting and sometimes treacherous world of tax.

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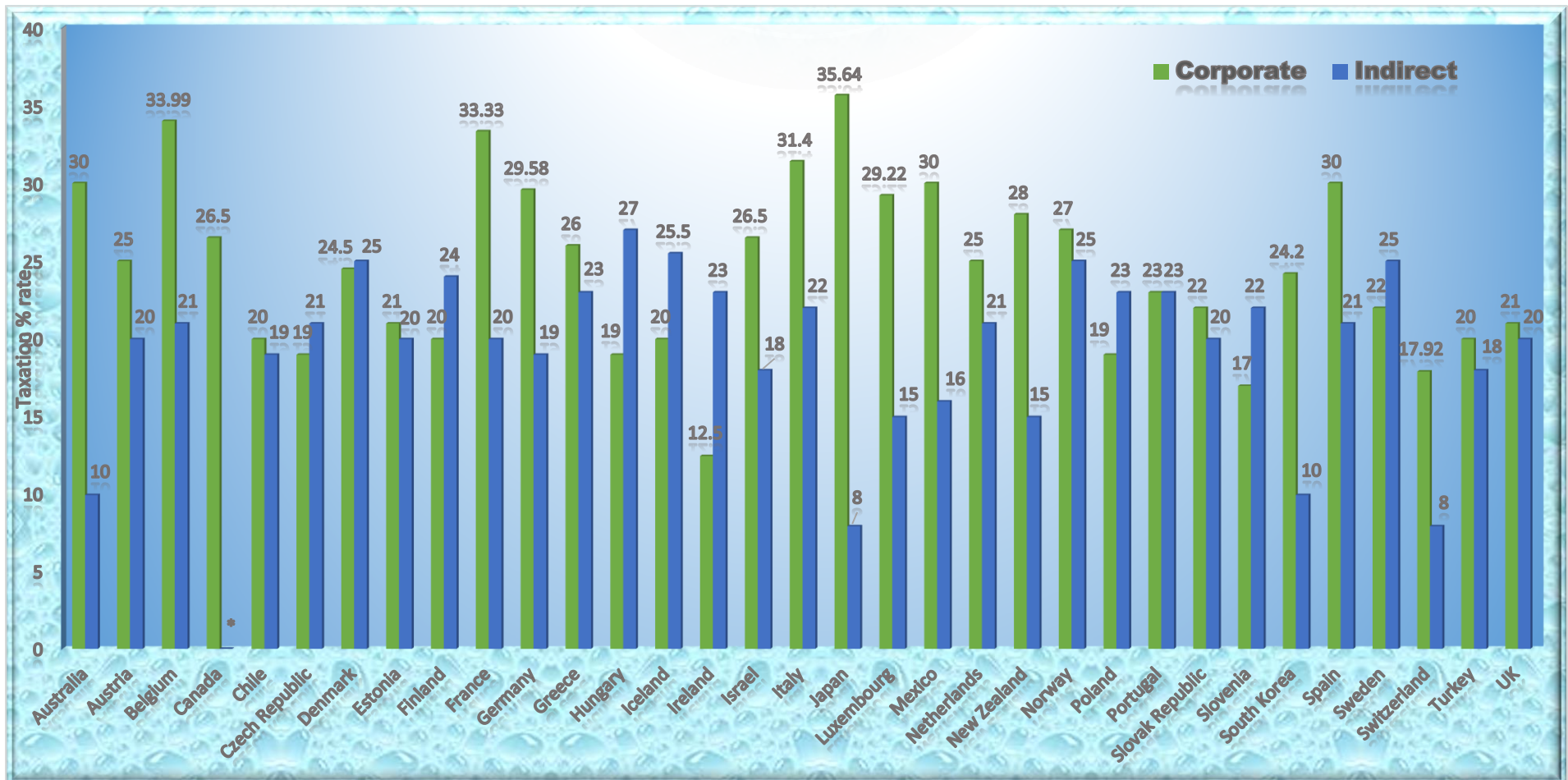
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APPENDICES

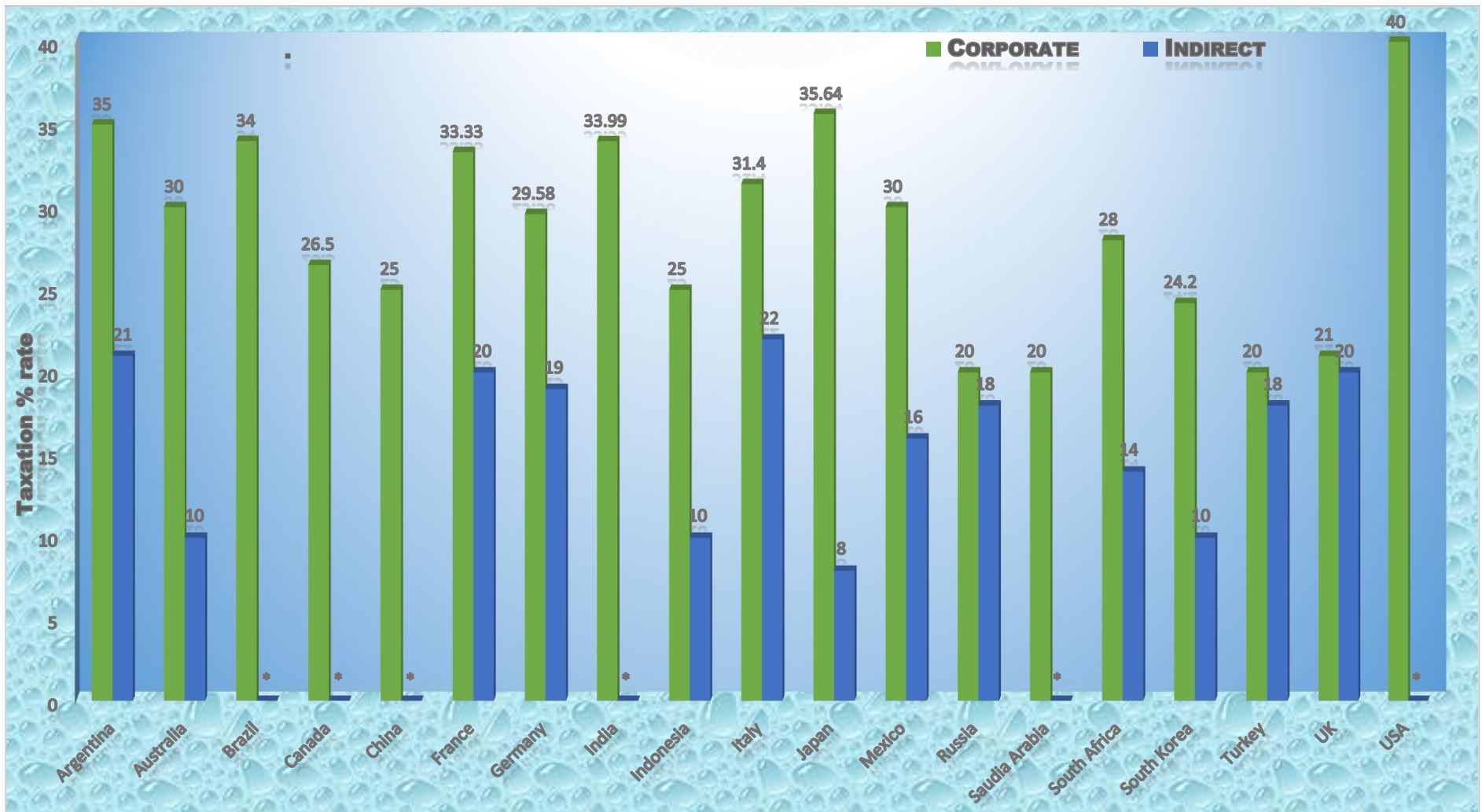
APPENDIX A: “At a glance – global corporate and indirect taxes in various countries”

The following two graphs A.1 and A.2 have been re-produced with permission obtained from KPMG, and can be viewed at <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Pages/corporate-indirect-tax-rate-survey.aspx> Corporate and Indirect Tax Rate Survey 2014 kpmg.com/tax.

GRAPH A.1 - Corporate and indirect tax rates in OECD countries.



GRAPH A.2 Corporate and indirect tax rates in G20 countries



NOTES:

1. Graph A.1 and A.2 - *Countries including Brazil, Canada, China, India, and the US impose indirect taxes of some sort not just at the federal/national level but also at their state, provincial, or municipal (or similar) level – and many of these levels have differences on what is taxed and at what rate.
2. Graph A.2 - Although the EU is a member of the G20, it has not been included in this chart as it would not be consistent to compare a region's average with the rates of individual member states.

APPENDIX B: Summary of all Treaties with South Africa, for the Avoidance of Double Taxation

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Algeria	-	-	-	-	21303 dd 21/06/2000	12-Jun-00
Australia	-	-	-	-	20761 dd 24/12/1999	21-Dec-99
Australia (Protocol)	-	-	-	-	31721 dd 23/12/2008	12-Nov-08
Austria	-	-	-	-	17965 dd 30/04/1997	06-Feb-97
Austria (Protocol)	-	-	-	-	35049 dd 28/02/2012	01-Mar-12
Austria (Protocol)	X					
Belarus	-	-	-	-	25914 dd 15/01/2004	29-Dec-03
Belgium	-	-	-	-	19437 dd 02/11/1998	09-Oct-98
Belgium (Protocol)	X	-	-	-	-	-
Botswana	-	-	-	-	26342 dd 12/05/2004	20-Apr-04
Botswana (Protocol)	-	21 May 2013 in Pretoria	X	-	-	-
Brazil	-	-	-	-	29073 dd 28/07/2006	24-Jul-06
Brazil (Protocol)	X	-	-	-	-	-
Bulgaria	-	-	-	-	27517 dd 22/04/2005	27-Oct-04
Cameroon	-	19 February 2015 in Yaoundé	-	-	-	-

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Canada	-	-	-	-	17985 dd 07/05/1997	30-Apr-97
Chile	-	11 July 2012 in Pretoria	X	-	-	-
China (PRC)	-	-	-	-	22041 dd 02/02/2001	07-Jan-01
Croatia	-	-	-	-	18460 dd 21/11/1997	07-Nov-97
Cuba	X	-	-	-	-	-
Cyprus	-	-	-	-	19638 dd 22/12/1998	08-Dec-98
Cyprus (Protocol)	X	-	-	-	-	-
Czech Republic	-	-	-	-	18603 dd 07/01/1998	03-Dec-97
Democratic Republic of Congo (DRC)	-	-	-	-	35805 dd 24/10/2012	18-Jul-12
Denmark	-	-	-	-	16891 dd 22/12/1995	21-Dec-95
Egypt	-	-	-	-	19706 dd 22/01/1999	16 12 1998
Ethiopia	-	-	-	-	28494 dd 10/02/2006	4 01 2006
Finland	-	-	-	-	16862 dd 01/12/1995	12 12 1995
France	-	-	-	-	16681 dd 27/09/1995	1 11 1995
Gabon	-	22 March 2005 in Pretoria	X	-	-	-

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Germany	-	-	-	-	3898 dd 25/05/1973	28 02 1975
Germany (Renegotiated)	-	9 September 2008 in Berlin	X	-	-	-
Germany (Protocol)	X	-	-	-	-	-
Ghana	-	-	-	-	29856 dd 18/05/2007	23 04 2007
Greece	-	-	-	-	24996 dd 03/03/2003	14 02 2003
Grenada					Proclamation 229 of 1946; Proclamation 271 of 1954 and Proclamation 32 of 1961	5 10 1960
Hong Kong	-	30 September 2014 in Pretoria and 16 October 2014 in Hong Kong				
Hungary	-	-	-	-	17438 dd 13/09/1996	5 05 1996
India	-	-	-	-	18545 dd 12/12/1997	28 11 1997
India (Protocol)	-	-	-	-	38440 dd 3/2/2015	26 11 2014
Indonesia	-	-	-	-	19766 dd 16/02/1999	23 11 1998
Indonesia (Protocol)	X	-	-	-	-	-
Iran	-	-	-	-	19637 dd 22/12/1998	23 11 1998
Ireland	-	-	-	-	18552 dd 15/12/1997	Ireland

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Ireland (Protocol)	-	-	-	-	35134 dd 22/03/2012	10 02 2012
Isle of Man (Limited)	X					
Israel	-	-	-	-	6577 dd 13/07/1979	27 05 1980
Italy	-	-	-	-	19823 dd 08/03/1999	2 03 1999
Japan	-	-	-	-	18391 dd 27/10/1997	5 11 1997
Kenya	-	26 November 2010 in Nairobi	X	-	-	-
Korea	-	-	-	-	16918 dd 26/01/1996	7 01 1996
Kuwait	-	-	-	-	29815 dd 20/04/2007	25 04 2006
Kuwait (Protocol)	X	-	-	-	-	-
Lesotho	-	-	-	-	17948 dd 22/04/1997	9 01 1997
Lesotho (Renegotiated)	-	18 September 2014 in Maseru	-	-	-	-
Luxembourg	-	-	-	-	21852 dd 06/12/2000	8 09 2000
Luxembourg (Protocol)	X	-	-	-	-	-
Malawi	-	-	-	-	1479 dd 13/08/1971	2 09 1971

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Malawi (Renegotiated)	X	-	-	-	-	-
Malaysia	-	-	-	-	29021 dd 13/07/2006	17 03 2006
Malaysia (Protocol)	-	-	-	-	35190 dd 29/03/2012	6 03 2012
Malta	-	-	-	-	18461 dd 21/11/1997	12 11 1997
Malta (Protocol)	-	-	-	-	37243 dd 24/1/2014	17 12 2013
Mauritius	-	-	-	-	18111 dd 02/07/1997	20 06 1997
Mauritius (Renegotiated)	-	17 May 2013 in Maputo	X	-	-	-
Mexico	-	-	-	-	33460 dd 24/08/2010	22 07 2010
Morocco	X	-	-	-	-	-
Mozambique	-	-	-	-	31983 dd 13/03/2009	19 02 2009
Mozambique (Protocol)	X	-	-	-	-	-
Namibia	-	-	-	-	19780 dd 19/02/1999	11 04 1999
Namibia (Renegotiated)	X	-	-	-	-	-
Netherlands	-	-	-	-	3153 dd 18/06/1971	20 01 1972
Netherlands (Renegotiated)	-	-	-	-	31797 dd 23/1/2009	28 12 2008

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Netherlands (Protocol)	-	-	-	-	31795 dd 23/1/2009	28 12 2008
Netherlands (Protocol)	X					
New Zealand	-	-	-	-	26798 dd 17/09/2004	23 07 2004
Nigeria	-	-	-	-	31241 dd 22/7/2008	5 07 2008
Norway	-	-	-	-	17504 dd 15/10/1996	12 09 1996
Norway (Protocol)	-	16 July 2012 in Pretoria	X	-	-	-
Oman	-	-	-	-	25913 dd 15/01/2004	29 12 2003
Oman (Protocol)	-	-	-	-	37244 dd 29/1/2014	5 11 2013
Pakistan	-	-	-	-	19849 dd 17/03/1999	9 03 1999
Poland	-	-	-	-	17201 dd 16/05/1996	5 12 1995
Portugal	-	-	-	-	31720 dd 23/12/2008	22 10 2008
Qatar	-	6 March 2015 in Pretoria	-	-	-	-
Romania	-	-	-	-	16680 dd 27/09/1995	21 10 1995
Russian Federation	-	-	-	-	21395 dd 20/07/2000	26 06 2000
Rwanda	-	-	-	-	33475 dd 27/08/2010	3 08 2010

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Saudi Arabia	-	-	-	-	31796 dd 23/01/2009	1 05 2008
Senegal	X	-	-	-	-	-
Seychelles	-	-	-	-	25646 dd 30/10/2003	29 07 2002
Seychelles (Protocol)	-		-	-	35396 dd 06/06/2012	15 05 2012
Sierra Leone					Proclamation 229 of 1946; Proclamation 271 of 1954 and Proclamation 32 of 1961	5 10 1960
Singapore	-	-	-	-	18599 dd 02/01/1998	5 12 1997
Singapore (Renegotiated)	X	-	-	-	-	-
Slovak Republic	-	-	-	-	20409 dd 25/08/1999	30 06 1999
Spain	-	-	-	-	30837 dd 12/03/2008	28 12 2007
Sudan	-	7 November 2007 in Cape Town	X	-	-	-
Swaziland	-	-	-	-	27637 dd 01/06/2005	8 02 2005
Swaziland (Protocol)	X	-	-	-	-	-
Sweden	-	-	-	-	16890 dd 27/12/1995	25 12 1995
Sweden (Protocol)	-	-	-	-	35268 dd 23/04/2012	18 03 2012
Switzerland	-	-	-	-	850 dd 29/09/1967	11 07 1968

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
Switzerland (Renegotiated)	-	-	-	-	31967 dd 06/03/2009	27 01 2009
Switzerland (Protocol)	X	-	-	-	-	-
Syria	X	-	-	-	-	-
Taiwan (Republic of China)	-	-	-	-	17408 dd 03/09/1996	12 09 1996
Tanzania	-	-	-	-	30039 dd 04/07/2007	15 06 2007
Thailand	-	-	-	-	17409 dd 03/09/1996	27 08 1996
Thailand (Protocol)	X					
Tunisia	-	-	-	-	20728 dd 15/12/1999	10 12 1999
Turkey	-	-	-	-	29464 dd 11/12/2006	6 12 2006
Turkey (Protocol)	-	25 December 2013 in Ankara	X	-	-	-
Uganda	-	-	-	-	22313 dd 24/05/2001	9 04 2001
Ukraine	-	-	-	-	27150 dd 10/01/2005	29 12 2004
United Arab Emirates	X	-	-	-	-	-
United Kingdom	-	-	-	-	24335 dd 31/01/2003	17 12 2002

Country	Treaties in process of negotiation or finalised but not yet signed	Signed not Ratified	Ratified in South Africa	Ratified in the other country	Published in Government Gazette	Date of Entry into Force
United Kingdom (Protocol)	-	-	-	-	34971 dd 02/02/2012	13 10 2011
United States of America	-	-	-	-	18553 dd 15/12/1997	28 12 1997
Zambia	-	-	-	-	Proclamations No 174 of 1956 and 60 of 1960	31 08 1956
Zambia (Renegotiated)	X	-	-	-	-	-
Zimbabwe	-	-	-	-	1234 dd 24/09/1965	3 09 1965
Zimbabwe (Renegotiated)	X	-	-	-	-	-

(As per SARS publication, i.e. LAPD-IntA-DTA-2013-01 - Status Overview of All DTAs and Protocols, also available on the official SARS website

<http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/default.aspx>.)

APPENDIX C: International Expansion Checklist

(As per the Deloitte School of Tax - publication, *Guide to International Expansion into Africa - International Expansion Checklist*)

CHECKLIST

<u>No.</u>	<u>Query</u>	<u>Yes/No</u>	<u>Action point if "Yes"</u>
Part A	<u>TAXATION IN FOREIGN COUNTRY</u>		
1	Will the activities in relation to the foreign country take place in South Africa (e.g. services rendered in South Africa)?		Check foreign country legislation for withholding taxes. Review South Africa tax rebate / deduction impact
2	Will the activities take place in the foreign country (i.e. will you establish a taxable presence in the foreign country)?		Obtain advice in the foreign country. Check if DTA applicable. If DTA, check whether activities create a permanent establishment ("PE").
3	If a presence will be created and a DTA would apply, then:		
	3.1 Is the income in the nature of business profits?		Check applicable article in DTA.
	3.2 Is the income flow in the nature of royalties?		Check applicable article in DTA.
	3.3 Is the income flow in the nature of interest?		Check applicable article in DTA.
	3.4 Is the income flow in the nature of dividends?		Check applicable article in DTA.
	3.5 Is the income flow in the nature of services fees?		Check applicable article in DTA.
	3.6 Is the income flow of another nature?		Check to see if applicable article exists in DTA.
	3.7 Will a rebate / deduction be available for foreign taxes suffered in target jurisdiction?		Review elimination of double taxation provisions in the DTA.

4 If a presence will be established, then:

Consider whether it would be more tax efficient to operate through a foreign branch or a foreign subsidiary. Refer to 4.1 to 4.9 for relevant questions.

4.1 What are the tax rates applicable in the foreign country?

Obtain advice in the foreign country.

4.2 Does the foreign country have a transfer pricing and thin capitalisation regime?

Obtain advice in the foreign country.

4.3 Does the foreign country levy capital gains tax?

Obtain advice in the foreign country.

4.4 What are the registration requirements in the foreign country?

Obtain advice in the foreign country.

4.5 Are there any local ownership rules and how do these impact on the structure?

Obtain advice in the foreign country.

4.6 How would an investment vehicle located in the foreign country be treated on repatriation of profits?

Obtain advice in the foreign country.

4.7 What are the withholding requirements in the foreign country?

Obtain advice in the foreign country.

4.8 Is there VAT/GST applicable in the foreign country?

Obtain advice in the foreign country.

4.9 If you are employing staff in the foreign country, what are the employer withholding obligations?

Obtain advice in the foreign country and then check foreign employment income article of applicable DTA.

<u>No.</u>	<u>Query</u>	<u>Yes/No</u>	<u>Action point if "Yes"</u>
5	If a subsidiary will be set up, then:		Consider whether it would be more tax efficient to hold it via an intermediary holding company jurisdiction. Refer to 5.1 to 5.8 for relevant questions.
	5.1 Does the intermediary holding company jurisdiction levy capital duties?		Obtain advice in the foreign country.
	5.2 What is the extent of the holding company's DTA network?		Obtain advice in the foreign country.
	5.3 What are the tax rates applicable in the foreign country?		Obtain advice in the foreign country.
	5.4 Are there transfer pricing and thin capitalisation provisions?		Obtain advice in the foreign country.
	5.5 Are there capital gains tax provisions?		Obtain advice in the foreign country.
	5.6 How would the intermediary holding company be taxed on repatriation of profits?		Obtain advice in the foreign country.
	5.7 Are taxes withheld on the remittance of dividends, interest, royalties and management fees? If so, at what rate (after taking DTA provisions into account)?		Obtain advice in the foreign country.
	5.8 What management structure will be put in place in the holding company jurisdiction?		Consider extent to which intermediary holding company could be regarded as effectively managed in South Africa.

Part B **TAXATION IN SOUTH AFRICA**

6 Are you operating through a branch?

As a branch is an extension of the South African entity, the income will form part of the South African company's income; however, losses will be ring-fenced. Consider whether it is better to operate through a subsidiary (consider differences in tax rates and whether CFC exemption would apply to CFC's income).

7 Are you operating through a subsidiary?

Consider whether the foreign company is a CFC (if yes, the income will be imputed to South Africa unless the NIL deeming provision or one of the exemptions applies).

8 If the foreign company is a CFC, will the net income to be imputed be deemed to be NIL?

Check whether aggregate foreign tax payable by the CFC is at least 75 percent of the amount of normal tax had the CFC been a South Africa tax resident.

<u>No.</u>	<u>Query</u>	<u>Yes/No</u>	<u>Action point if "Yes"</u>
9	If the foreign company is a CFC and net income to be imputed is not deemed to be NIL, then will any of the following exemptions apply:		
9.1	Is the net income attributable to a business establishment, which operates at arm's length in the foreign country?		Refer to section 9D.
9.2	If a capital gain has arisen, is this attributable to a business establishment of a CFC?		Refer to section 9D.
10	Do you qualify for a rebate or deduction in relation of the foreign tax?		Check whether the income is from a foreign source or South Africa source. If a foreign source, a rebate may be claimed. If South Africa source, a rebate or a deduction may be claimed. Where a DTA is applicable, consider elimination of double tax and DTA specific source rules.
11	If you qualify for a rebate both in terms of section 6quat and a DTA, which rebate do you wish to elect?		Section 6quat has more extensive rebate rules, in terms of allowing the carry forward of any excess credits, whereas DTA's do not provide for this, except for more recent DTA's which may refer back to local legislation (<i>i.e. to section 6 quat</i>).
12	If you have a tax exposure in South Africa, have you considered the applicability of any DTA?		Consideration also needs to be given to DTA in determining the allocation of taxing rights in South Africa.
13	If the branch is loss-making, have you remembered not to set-off its loss against South African source income?		

Part C

Other Considerations

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| 14 Have you put in place a transfer pricing policy which documents the arm's length price for any international (cross-border) transactions with connected persons? | Transactions should be priced as though between parties acting at arm's length. |
| 15 Have you made any loans to connected persons on which you charge interest? | An arm's length rate of interest needs to be determined and charged in order to avoid a potential income tax adjustment and STC. |
| 16 Have you considered the foreign country withholding obligations relating to employment income? | Determine whether there are any individual and withholding tax obligations. |
| 17 Have you received any foreign dividends? | Check whether any of the exemptions are applicable, otherwise these dividends will be taxable. |
| 18 Have any of the assets of your branch or subsidiary been disposed of? | Determine whether CGT is payable in relation to the disposal. |
| 19 Have you obtained the necessary exchange control approvals for transactions involving the flow of funds between South Africa and the foreign country. | Exchange control approval or reporting to the South African Reserve Bank is required with the flow of certain funds to and from a foreign country. |
| 20 If you have a foreign branch, have you determined its income in the currency used by the branch for purposes of financial reporting before translating it to rand at the average exchange rate? | |