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SCHOOL OF ACCOUNTANCY

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A comparative analysis of income tax provisions applied to cross border secondment arrangements in South Africa and the UK

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Abstract

The world has in recent years become increasingly interconnected as a result of massively increased trade and cultural exchange, and cross-border mobilisation is more frequently discussed in many companies. Most multi-national companies have a global mobility policy in place, which sets out the parameters for cross-border employment. As the internationalisation of South African business activity sped up enormously over the last half century, cross border employment will be one of the priorities for South African multinational companies as well as the South African Revenue Service ('SARS'). (Mohan, 2016.)

The purpose of this report is to examine and compare the legislative, administrative and judicial approaches to cross border employment in South Africa and contrast this with those adopted and endorsed by the United Kingdom. This report will also analyse the implications of an entity creating a permanent establishment through secondment contracts and also tax implications for the employees. The report will provide a comprehensive analysis of the income tax provisions applicable to the residency and non-residency of both the entity and the individual, thus analysing the definition of a resident in s 1 of the Income Tax Act 58 of 1962 in South Africa and UK section 1A(4) of the Finance Act of 2019 in the United Kingdom.

The United Kingdom has been rated one of the top countries where South Africans would like to work and to which South Africans would like to emigrate (BusinessTech, 2020). The United Kingdom is also one of South Africa's main trade partners (IOL Business, 2020). South Africa has a double tax agreement with the United Kingdom. South Africa and the United Kingdom are on a progressive tax system. (SARS 2021) (Brady, 2019)

Key Words: cross-border, resident, non-resident, deemed resident, employment, taxable income, OECD, multinational, permanent establishment, remuneration, exemption, tax resident, tie breaker, retirement savings, domestic legislation, remote working, double tax agreement.

Declaration

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

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Thulile Sibeko

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Chapter 1: Introduction

1.1 Background

Secondments have become part of the modern workplace. Secondments can be a beneficial way to assist employees to gain new skills and experience while the employer is also meeting short-term staffing needs, such as maternity cover. In other instances where the organization is experiencing low turnover rate, secondment arrangements can be a useful way to introduce a different fresh perspective into the organisation as well as new ideas and skills. (Springer, 2014.)

There are two types of secondments: internal and external. Internal secondments happen within a one company, external secondments happen between two or more companies. Employees should only be required to go on secondments where it is fitting and beneficial for the organisation or capable of enhancing the employee's performance in their role and improve the company's productivity. Management should be clear on what their aims and objectives are and how these will be executed and achieved before entering into a secondment arrangement. This requires a strong involvement of the company's human resources department. (Morall, 2018.)

Employees with technical and management expertise are a desirable resource and are very mobile in the modern world and think nothing of moving across the borders, either permanently or on secondment (Morall, 2018). There are various reasons for cross-border employment for an entity, either to upskill the workforce or cut costs.

Secondment fundamentally means an individual is moved from one department within the same employer or "from one employer to another on a temporary basis". The scenario that will be analysed in detail in this report is where the secondment agreement is between one employer to another on a temporary basis in such a way that the secondee remains the legal employee of the original employer and will, at the end of secondment return to the premises of the original employer (Morall, 2018). It is therefore important to differentiate between a contract for services where one entity is in agreement to provide a specific service through the use of its own employees to another entity or a contract of services where an employer-employee relationship exists (Morall, 2018). The distinction in law is not between a 'contract of services' and a 'contract for services'. The distinction is between a contract for the rendering of services (ie an employment contract), known in Latin as locatio conductio operarum, and a contract for the letting and hiring of a job of work (where the worker is an independent contractor), known in Latin as locatio conductio operis.

A secondment arrangement constitutes an arrangement where a resource performs the business activities of his original formal employer who ultimately carries the responsibility or risk for the results produced by that resource provided to another entity (OECD, 2014, C (15)-16).

Globally mobile employees can launch a significant permanent establishment risk for the formal employer in the foreign country to which the employee is being seconded (OECD, 2014, C (15)-7 - 8). The duration that the formal employee is present in a foreign jurisdiction for work purposes can also have significant effects in terms of creating a service permanent establishment (Morrison, Reilly & West, 2009).

The structure of a secondment arrangement is crucial as this might have significant negative implications in the taxation of business profits in the foreign jurisdiction where services are being rendered if the secondment contract constitutes a permanent establishment (OECD, 2014, C (7) -1 - 4). if the non-resident employer has a permanent establishment and the taxable profits are attributable to that permanent establishment, those business profits would be taxable in such a jurisdiction (OECD, 2014, C (7) -1 – 4).

1.2 Research Question

How the income tax consequences of a secondment arrangement compare for the South African resident employee and employer in South Africa and the United Kingdom being the secondment destination and vice versa?

This report will analyse how a secondment contract can create a service permanent establishment for a non-resident entity and implications of a DTA when in place.

For this report South Africa and the UK have been identified as prime cross-border employment destinations (CBN, 2019). A comparison will be done of the two countries, comparing the individual and company tax implications resulting from a permanent establishment through a secondment contract.

1.3 The sub questions

The following sub questions will be answered to address the main research question:

1.3.1 What is a resident? The definition of a resident will be analysed in terms of s 1 of the Income Tax Act 58 of 1962 and UK statutory resident test (Smith, 2020).

1.3.2 What is a secondment arrangement?

A secondment arrangement constitutes an arrangement where a resource performs the business activities of his original formal employer who carries the responsibility or risk for the results produced by that resource provided to another entity (OECD, 2014, C (15)-16).

1.3.3 What are the South African tax provisions applying to resident and non-resident employers and employees in secondment arrangements? This sub question will analyse the applicable tax rates for the 2021 year of assessment and tax thresholds (SARS, 2021) as well as certain provisions of the Act as discussed below. The following definitions in s 1 will be analysed: company, gross income, permanent establishment, taxable income and year of assessment. S 5(1) and s 5(2) of the Act provide for the levy of tax and the tax rates, which will be examined.

1.3.4 What are the United Kingdom's income tax provisions for non-resident individuals and companies on cross border employment through secondment contracts. In the United Kingdom, income tax provisions are executed by the Her Majesty's Revenue and Customs (HMRC). Taxable income for a resident and non-resident will be addressed. The sub-question will address the tax thresholds as specified s 10(5) of ITA 2007, s 35(1) of ITA 2007 for the 2020 year of assessment. The definitions of an assessment year, company in Companies Act 2013, resident and non-resident person specified in Statutory Resident Test in Finance Act 2013 and total taxable income will be discussed.

3.2.5 How does a secondment contract create a service permanent establishment for a non-resident entity? (OECD, 2014, C (5)-31 – 32). The answer to this question will address the meaning of a permanent establishment. According to Article 5(1) in the OECD Model Tax Convention, a permanent establishment is defined as a 'fixed place of business, through which the business of an enterprise is wholly or partly carried on (OECD, 2014, C (5)-1 - 2).

1.4 Research Methodology

The research will be qualitative in nature. The primary sources to be analysed will include legislation, OECD material, DTA, journal articles and case law as these clarify the main objectives of the report in analysing the tax consequences of cross border secondment arrangements, including the creation of a permanent establishment.

The tax rates applicable to companies and individuals depending on their residency will be examined. The other source material will include the income tax legislation of South Africa and the United Kingdom. Country specific legislation will be examined to analyse the definition of resident, income and assessment period in each country.

Chapter 2: Income Tax provision for tax residents in South Africa and the UK

2.1 What is a resident in South Africa?

2.1.1 Natural person

For South African tax purposes, a resident is defined in s 1 of the Income Tax Act 58 of 1962 (the Act), as a natural person who is –

- is ordinarily resident in the Republic; or
- meets all the requirements of the physical presence test,

and is not deemed to be exclusively a resident of another country for the purposes of the application of any tax treaty (para a(1) s 1 of ITA 1962)

A natural person is ordinarily resident in South Africa if it is his or her permanent home, to which he or she will normally return, is in South Africa (*CIR v Kuttel*). In ascribing a meaning to the concept of ordinarily resident, the courts have held the following:

- A residence that is settled and certain and not temporary and casual (*Soldier v COT*).
- Where a person normally resides, apart from temporary or occasional absences (*CIR v Kuttel*).

A South African tax resident is a natural person who becomes ordinarily resident in South Africa and their tax residency will be effective the same day they are ordinarily resident in South Africa (Interpretation Note 3, 2002: 7). The South African income tax system evolved into a residence basis from a source-based system of taxation from years of assessment commencing on or after 1 January 2001 (Stiglingh et.al, 2014: 59).

Any person that was a resident and ceases to be resident during the year of assessment must be regarded as not being resident from the day on which that person ceases to be resident (Mitchell et al, 2015).

The definition of resident also includes definition of what a ‘day’ is for purposes thereof:

> ‘a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a ‘port of entry’ as contemplated in Section 9(1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act’

In the application of the resident test to natural persons, a few general observations can be made. Firstly, ‘ordinary residence’, and the ‘physical presence’ test are the two separate tests for residence. In other words, to determine whether or not a person is a resident of South Africa two tests are applicable—and if either one applies, the individual will be regarded as being ‘resident’ in South Africa for tax purposes and will be taxed in the South African jurisdiction.

A second general observation is that any person will be specifically excluded from the definition of ‘resident’ as defined in s 1 of the Act if that person is deemed to be exclusively resident in another country for the purposes of applying any double tax agreement entered into between the governments of South Africa and that other country for the avoidance of double taxation (Mitchell et al, 2015).

2.1.1.1 The ‘ordinarily resident’ test

The Act does not define ‘ordinarily resident’, and whether a person is ‘ordinarily resident’ is determined based by facts and interpretation given by the court. In *Cohen v CIR, 1946 AD 174; 13SATC 362*, it was acknowledged that it has long been established that a person may have more than one residence for the purpose of income tax. In *CIR v Kuttel, 1992 (3) SA 242 (A); 54 SATC 298*, the court held that a person may however have more than one residence at a time. It was unclear whether a person can be ‘ordinarily resident’ in more than one country. The court suggested that a person’s ordinary residence would be the country to which they would naturally return from their wanderings. It would be natural to interpret ‘ordinarily’ by reference to the country of their most fixed or settled residence, and therefore a person can only be ‘ordinarily resident’ in one country.

In the Cohen case, the court held that the individual's conditions of ordinary residence could be determined by evidence of their mode of life outside of the year of assessment under consideration as opposed to solely their actions during that particular year of assessment in answering the question of whether the individual was a resident in South Africa, or elsewhere, any one year of assessment. (Mitchell et al, 2015)

Two requirements need to be present combined with passing a physical presence test to be ordinarily resident in South Africa, namely, an intention to become ordinarily resident in South Africa, and secondly, steps indicative of this intention having been or being carried out. (Interpretation Note No. 3 (Issue 2), 2018: 4)

A natural person may be resident in South Africa even if that person was not physically present in South Africa during the relevant year of assessment, and that the purpose, nature, and intention of the taxpayer's absence must be established to determine whether the taxpayer is still ordinarily resident. (Interpretation Note No. 3 (Issue 2), 2018: 5)

Interpretation Note No. 3 (Issue 2), in determining whether a person is ordinarily resident in South Africa, the following factors must be considered (Interpretation Note No. 3 (Issue 2), 2018: 5)

- habitual abode, i.e. present habits and mode of life;
- place of business and personal interest;
- location of personal belongings;
- most fixed and settled place of residence;
- family and social relations (schools, church, etc.);
- political, cultural, or other activities;
- application for permanent residence;
- frequency of (and reasons for) visits.

The circumstances of the individual must be examined as a whole, and the personal acts of the individual must be carefully considered. The taxpayer's life beyond the particular period under consideration must be looked at (ITC 1170,34 SATC 76).

2.1.1.2 The ‘physical presence’ test

As stated above, in terms of the definition of a ‘resident’ in s 1 of the Act, a ‘resident’ includes any natural person who is not at anytime during the relevant year of assessment ordinarily resident in South Africa, if that person was physically present in South Africa:

- for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as
- for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment, and
- for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment.

The presence test explicitly only applies if a person was not ordinarily resident in South Africa at any time during the relevant year of assessment and can therefore not be applied in the year of assessment that a taxpayer either ceases to be ordinarily resident in South Africa or commences being ordinarily resident in South Africa. (Interpretation Note No. 3 (Issue 2), 2018: 7.)

A person who is not ordinarily resident in South Africa is, in terms of the physical presence test, an ordinary resident after physical presence in South Africa exceeding the above limits over a period of six consecutive years of assessment. (Mitchell, et al, 2015).

A person who becomes tax resident by virtue of successfully meeting physical presence test will become a tax resident from the first day of the year of assessment during which all the requirements of the physical presence test are met. (Mitchell, et al, 2015).

A part of a day is deemed to be a full day in order to determine the number of days a person is physically present in South Africa. A day one spends in transit through South Africa is not counted as a full day when trying to establish the number of days a person is physically present in South Africa, provided that the person does not formally enter South Africa through a "port of entry" in terms of s 9(1), Immigration Act, 2002.

If a person is exclusively resident in another country in terms of a double tax agreement, that person cannot be regarded as a tax resident in South Africa. (Interpretation Note No. 3 (Issue 2), 2018: 7)

2.1.2 Juristic Person

A juristic person is regarded as being resident in South Africa under s 1(1) of the Income Tax Act if such juristic person is:

1. incorporated in South Africa; or
2. has its place of effective management (the POEM) in South Africa.

A company can only have one place of effective management at any given time but may have more than one place of management. There are multiple facts that need to be considered, often involving multiple locations, and from those facts and locations it is therefore necessary to determine a single dominant place where effective management is located (Interpretation Note: No.6 (Issue 2), 2015)

Interpretation Note: No.6 (Issue 2), 2015 draws attention to certain facts and circumstances to be considered when establishing the POEM of an entity:

- The place where the company's head office is situated and where senior management and their support staff are predominantly located is usually the place where key management decisions are made. Where members of senior management operate from different locations, the head office is likely to be the place where the highest level of management is located. Where management is so decentralised that it is impossible to determine the company's head office with a reasonable degree of certainty, the location of the company's head office would be of less relevance in determining the POEM.

- Decisions taken by shareholders of a company generally affect the existence of a company as opposed to its business. These decisions are therefore not relevant in determining the POEM of a company. However, they can become relevant where the shareholder usurps the power of a director and influences the POEM. This consideration usually becomes relevant where a company is wholly owned by one shareholder, and such a shareholder usurps the directors' role of managing the company.

- The place where the company's board has chosen to delegate some or all of its authority to a committee, and the place where such a committee is based, will often be the POEM. The nature of the delegation must be taken into account, and whether or not key management decisions have been delegated. If the board delegates its authority to senior management, the place where those senior managers are located will often be the POEM.

- The place where the board meets is an important factor in determining the POEM, depending on the role the board has in key management and taking key commercial decisions. The physical location of a board meeting may not be the place where key commercial decisions are in substance made, when considering the advances of technology and video conferencing tools used in business today. Considerations of who joined the conference and who was physically present should be factored in along with the location of such board meetings to determine the POEM of an entity.

- Operational management decisions (day-to-day business operations) should be distinguished from broader top level management decisions, with the latter being a key consideration in establishing the POEM.

- Managers in charge of centralised support functions such as human resources, data management, customer support or accounting are often located in countries with superior infrastructure. These locations are often separate from where senior managers are located or where a company's head office is located. Although these services are essential to the company, the managers in charge are not involved in key management and commercial decisions of the business as a whole, and therefore their location would be of limited significance in the consideration of the POEM.

If a juristic person earns income from a foreign source outside of South Africa, is not incorporated and does not have its place of effective management in SA, the company is not a 'resident' as defined for South African income tax purposes and no income tax liability arises.

An international headquarter company is, however, excluded. The term place of effective management is not defined in the Act and the ordinary meaning of the words, taking into account international precedent and interpretation, will assist in ascribing a meaning to it. (Mitchell et al, 2015)

The concept of effective management is not the same as shareholder control or control by the board of directors. Management focuses on the company's purpose and business and not on the shareholder-function. In order to determine the meaning of place of effective management, one should keep in mind that it is possible to distinguish between- the place where central management and control is carried out by a board of directors

- the place where executive directors or senior management execute and implement the policy and strategic decisions made by the board of directors and make and implement day-to-day/regular/operational management and business activities;
- the place where the day-to-day business activities are carried out/conducted.

(ENS Africa, 2016)

The place of effective management is the place where the company is managed on a regular or day-to-day basis by the directors or senior managers of the company, irrespective of where the overriding control is exercised, or where the board of directors meets. Management by these directors or senior managers refers to the execution and implementation of policy and strategy decisions made by the board of directors. It can also be referred to as the place of implementation of the entity's overall group vision and objectives. Management structures, reporting lines and responsibilities vary from entity to entity, depending on the requirements of the entity, and no hard and fast rules exist. It is therefore not possible to lay down absolute guidelines in this regard. (ENS Africa, 2016)

2.2 What is a resident in the UK

2.2.1 Natural persons

For UK tax purposes, the term "resident" has a specific, technical meaning in relation to individuals. For tax years 2012-13 and earlier, an individual's residence status is determined by the case law-based rules before the implementation of the statutory residence test. For tax years 2013-14 onwards, an individual's residence status is determined by the application of a statutory residence test introduced by the Finance Act 2013 with effect from 6 April 2013. The UK tax year runs from 6 April in each year to 5 April the following year. An individual's UK residency status is determined using the Statutory Residence Test (Smith, 2020).

The statutory residence test is made up of the following types of tests (Smith, 2020):

1. Automatic overseas test;
2. Automatic UK test; and,
3. A sufficient ties test.

2.2.1.1 Automatic overseas test

An individual will meet the conditions of the automatic overseas test if one of the following conditions applies:

- The individual has been resident in the UK for one or more of the previous 3 tax years and will spend fewer than 16 days in the UK in the tax year; or
- The individual has not been resident in the UK in any of the previous 3 tax years and will spend less than 46 days in the UK in the tax year; or
- The individual works sufficient hours overseas in the tax year (there is a specific statutory test to determine this), spends fewer than 91 days in the UK in the tax year, and no more than 30 days are spent working in the UK.

2.2.1.2 Automatic UK test

An individual who does not meet the sufficient ties test and the automatic overseas test will be regarded as automatically resident in the UK if:

- the individual spends 183 days or more in the UK in a tax year; or
- the individual has a UK home for at least 91 consecutive days, at least 30 of which are in the relevant tax year (whether consecutively or otherwise). Additionally, the individual has to be present in the home on at least 30 days in the tax year - whether consecutively or otherwise. Finally the individual has to have no homes abroad throughout the 91 day period in which they are present on 30 or more days in the tax year; or
- the individual works sufficient hours (there is a specific statutory test to determine this), in the UK over a period of 365 days during which more than 75 percent of workdays are UK workdays and at least 1 of those days occurs in the relevant tax year.

For these purposes a workday is a day with more than 3 hours of work and may include travel time. An individual is generally treated as being in the UK for a day if present in the UK at midnight.

If none of the automatic overseas tests and none of the UK tests are met an individual must consider the sufficient ties test to determine their UK residence.

2.2.1.3 Sufficient ties test

If the UK automatic test and the overseas automatic test are not satisfied, particular ties that an individual may have with the UK and the number of days that the individual spends in the UK have to be considered.

The ties considered are:

- a family tie;
- an accommodation tie;
- a work tie
- a 90-day tie; and
- a country/jurisdiction tie (only considered when the individual has been UK resident in one or more of the previous 3 tax years).

The more ties an individual has with the UK, the fewer the number of days that can be spent in the UK before the individual establishes UK residence for a tax year.

2.2.1.4 Domicile

A person's domicile is, generally, the individual's permanent home. Most foreign nationals employed by foreign employers who are extended business travellers or working on secondment to the UK are not regarded as domiciled in the UK.

2.2.2 Juristic person

The word "resident" is defined as a person, other than a natural person, which is-

- incorporated, established or formed in the UK; or
- which has its place of effective management in the UK.

UK incorporated companies are generally treated as UK resident. However, companies resident in the United Kingdom under domestic law, but treated as solely resident in a different country under that country's DTA with the United Kingdom, are not treated as UK resident for the purposes of UK domestic tax law.

Companies incorporated overseas are also treated as UK resident if their central management and control is situated in the United Kingdom. This means if the place of the highest form of control and direction over a company's affairs, as opposed to decisions on the day-to-day running of the business, is in the UK.

If the nature of the person, other than a natural person, is such that the business operations/activities are conducted from various locations, one needs to determine the place with the strongest economic nexus. (Barnerjee, Datta, 2015:7)

- Where the centre of senior/ executive management is located;
- Location of and functions performed at the headquarters;
- Where the business operations are actually conducted;
- Where controlling shareholders make key management and commercial decisions in relation to the company.

- Legal factors such as the place of incorporation, formation or establishment, the location of the registered office and public officer:
- Where the directors or senior managers or the designated manager, who are responsible for the day-to-day management, reside; · The frequency of the meetings of the entity's directors or senior managers and where they take place; · The experience and skills of the directors, managers, trustees or designated managers who purport to manage the entity; · The actual activities and physical location of senior employees;
- The scale of onshore as opposed to offshore operations;
- The nature of powers conferred upon representatives of the entity, the manner in which those powers are exercised by the representatives and the purpose of conferring the powers to the representatives. (Barnerjee et al, 2015:7)

2.3 Tax Implications for residents and non-residents in South Africa

Residents in South Africa are subject to pay tax on their worldwide income and capital gains (subject to certain exclusions), while non-residents only have tax liability on their South African sourced income. A non-resident rendering services in South Africa, will not be subject to tax on his/ her income from employment in South Africa, provided he/she meets the conditions of the DTA. (National Treasury, n.d)

South Africa previously applied the source-basis of taxation and has since changed to the residence-based system from 1 January 2001 (Stiglingh et.al, 2014: 59).

A country's right to tax depends on whether the activities that generated the income took place within the country's borders in a source-based jurisdiction. The source-based tax system has no regard for the taxpayer's place of residence. If the amount originated from a South African source or a source deemed to be from South Africa were only subject to tax in the Republic. (Olivier & Honiball, 2011:11)

In March 1997 the Katz Commission produced and published the Katz report, the purpose which was to analyse, discuss and provide recommendations to the then proposed change of the South African tax system from a source-based system to a residency-based system. The document contained comprehensive recommendations in relation to the source and residence principle. (Katz Report, 1997.)

These recommendations established the way for the introduction of the residence-based system from 1 January 2001 going forward. Both natural and juristic South African residents, would become taxable on their worldwide taxable income, regardless of the source of such income. Non-residents would however only be taxed on taxable income from a South African source or deemed to be from a South African source. (Katz Report, 1997.)

The application of the residence basis of taxation is justified by the rationale that residents can be called upon to contribute towards the cost of good order and government providing the resident with protection (National Treasury, n.d). Residents are subject to tax on their worldwide receipts under the residents basis of taxation, regardless of the source of the income that is received by the resident. (Stiglingh et al, 2014:59). The taxation of income accruing or received from services rendered and goods sold by the resident is in direct correlation between South Africa and the income that is earned (Olivier & Honiball, 2011:19). Although the residence basis of taxation has been adopted for income tax purposes, the source basis of taxation is applied for the taxation of non-residents in South Africa (Olivier & Honiball, 2011:19).

Section 11(2)(l) of the VAT Act reads as follows: where a supply of services would be charged with tax at the rate referred to in section 7(1), such supply of services shall...be charged with tax at the rate of zero per cent where the services are supplied to a person who is not a resident of the Republic.

Section 7(1) of the VAT Act states that

> ‘subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax to be known as the value-added tax (a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him; (b) on the importation of any goods into the Republic by any person on or after the commencement date; and (c) on the supply of any imported

services by any person on or after the commencement date, calculated at the rate of 15% on the value of the supply concerned or the importation, as the case may be.'

The above legislation means the secondment fee may or may not attract VAT if the original employer is registered as vendor for VAT purposes.

From 1 March 2020, beginning of the 2021 year of assessment, section 10(1)(o)(ii) of the Income Tax Act was amended to restrict or limit the exemption to R1.25 million of taxable foreign employment income. This means that foreign earned income over the limit becomes taxable income, to which the income tax tables are applied on a progressive scale. Resident expats have to continue complying with the 183-day requirement (and more than 60 consecutive full days) in order to qualify for the capped R1.25 million exemption.

Before 1 March 2020, there was no monetary restriction on the exemption for foreign employment income. Tax residents living and working abroad, for adequate days in any consecutive period of twelve months, could enjoy full exemption of their foreign employment income.

Non-residents in South Africa are subject to tax on income earned from the South African source, where income accruing to or received by a non-resident from a source in or deemed to be in South Africa is taxed for income tax purposes following the application of deductions and exemptions as allowed by the Income Tax Act (Stiglingh et.al, 2014:70). The source basis of taxation is dependent on a direct correlation between the income accruing or received by a person and South Africa (Honiball & Olivier, 2011:9).

The reasoning behind the application of the source basis of taxation is that residents should contribute to the costs of infrastructure and running the country, which have enabled the generation of income for the fiscus (Honiball & Olivier, 2011:11). There is no definition of term source in the Income Tax Act therefore, guidance is sought from case law in the determination of the meaning of the term for the purposes of income tax. The general approach in the determination of source is that source is not a legal concept but something considered as a real source of income (*Rhodesia Metals Ltd v COT* (1938 AD) at 379*)*.

The Income Act defines "gross income" in relation to a non-resident as the "total amount, in cash or otherwise, received by or accrued to" an individual (excluding receipts of a capital nature) in any given year of assessment, from a source within South Africa (Income Tax Act 58 1962, s 1(1)). A non-resident is generally entitled to the same deductions and rebates as a resident and will pay income tax at the same rate as a resident. Income from employment should be taxed in the country where the services are actually rendered, irrespective of the place where the contract is entered into, where the employer is based or where the remuneration is paid. In other words, a non-resident working in South Africa is potentially subject to income tax under South African domestic law for employment income earned in South Africa.

The non-resident's tax position may, however, be affected by a tax treaty that has been entered into between South Africa and the UK if the non-resident is regarded as a resident of the UK for tax purposes. Generally, a non-resident employee's remuneration package consists of –

- salary – the salary is taxable (bonuses are also taxable) and
- allowances – allowances are generally also taxable

All these amounts are added together to arrive at a non-resident employee's taxable income.

The authoritative case of *CIR v Lever Bros (*1946 AD 441), relating to the determination of the source of income, following a consideration of specific source rules that are contained in s 9 of the Income Tax Act, it was held that two factors are to be confirmed in determining of the source of income, the activities which generated the income, known as the 'originating cause' (Haupt, 2013:37) and determining the geographical location of the originating cause (Haupt, 2013:37

Salary income earned in South Africa by a non-resident will be attract income tax in South Africa, unless DTA entered into between South Africa and the UK stipulates otherwise. (Oury Clark, n.d)

Employment income generated from services rendered in South Africa by a non-resident is subject to normal tax in South Africa. The income will not be subject to income tax provisions in South Africa if a DTA is in existence and all three of the following requirements are met (Oury Clark, n.d):

- He or she is present in South Africa for a period or periods in aggregate not exceeding 183 days in any 12-month period (not necessarily a year of assessment).
- His or her remuneration is paid by, or on behalf of an employer who is not a resident of South Africa.
- His or her remuneration is not borne by a 'permanent establishment' that the foreign employer has in South Africa. A 'permanent establishment' is a complex concept, especially determining the establishment of one but in essence means a fixed place of business through which the business of the employer is wholly or partly conducted.

The amount of a non-resident's tax liability is determined by applying the applicable tax rate to that non-resident's taxable income. The amount of taxable income can be calculated by the following steps: (Haupt, 2013,44)

(1) Determine the amount of gross income derived by the non-resident. Gross income is the total amount, excluding amounts of a capital nature, received by or accrued to a non-resident in a given year of assessment, from a source or deemed source within South Africa.

(2) Deduct the aggregate amount of exemptions that the non-resident is entitled to from that non-resident's gross income. The difference is known as income.

(3) Subtract allowable deductions available to the non-resident from his or her income and add any South African taxable capital gains derived by that non-resident. The result will be the taxable income derived by the non-resident that is subject to South African income tax.

The basic theoretical model for deriving taxable income is set out in the table below based on the Income Tax Act 58 of 1962. (PWC, 2020)

	Gross income	xxxxxx
less:	Exempt income	(xxxxxx)
	Income	**xxxxxx**
less:	Allowable deductions	(xxxxxx)
add:	Taxable capital gains	xxxxxx
	Taxable income	**xxxxxx**

A non-resident who generates income from rendering services in South Africa where there is a Double Tax Agreement (DTA) in existence, should not be subject to pay income tax in South Africa, if the non-resident is physically present for one or more periods of less than 183 days in South Africa. In order to qualify for the exemption, the non-resident is required to fulfil these conditions:

- the individual must not be present for more than 183 days in the country in which he/she is temporarily rendering the service; and
- the individual's home country employer must not have a permanent establishment in the other country where the services are being rendered, which bears the costs of the individual's remuneration.

If the entity receiving the services is seen to be the non-resident's employer in terms of the DTA, one of the conditions of the dependent personal services article of the DTA will not be met, and the individual will not be tax-exempt.

South Africa will likely have the right to tax the income earned from the work that the non-resident did in South Africa, irrespective of whether he spend 183 days or more in South Africa.

This could result in double taxation and subsequent cash flow issues for the non-resident should he/she also be subject for tax in the country where he is considered to be a tax resident. It is important to note that although South Africa is one of the non-member economies with which the OECD has working relationships, based on certain facts and circumstances, the South African Revenue Service may subscribe to the guidelines issued by the OECD.

2.4 Income Tax Implications for residents and non-residents in the UK

Natural persons who are resident and domiciled in the United Kingdom are taxed on their worldwide taxable income and taxable capital gains. Non-resident natural persons in the UK will usually be taxed on their UK-source income. (GOV.UK, n.d)

The tax system in the UK is a progressive tax system where tax is charged at graduated rates, with higher rates of income tax applying to higher bands of income. (Brady, 2019)

An individual's liability to income tax in the UK is determined by residence status for taxation purposes and the source of income derived by the individual. Income tax is levied at progressive rates on an individual's taxable income for the year, which is calculated by subtracting allowable deductions from the total assessable income. (Brady, 2019)

Individuals calculate gross income based on total wages or salary before any tax deductions are subtracted. Other sources of gross income include rental income, tips, capital gains, dividends, interest income, and alimony. After subtracting above-the-line deductions, you are left with adjusted gross income. Further below-the-line deductions are subtracted from adjusted gross income to arrive at taxable income. Depending on the number of deductions or exemptions that apply, taxable income can be significantly less than gross income. (Brady, 2019)

Gross income represents the amount that a company earns from the sale of goods or services, excluding the costs of those goods and services. It is the simplest measure of a company's profitability, and often represented as gross profit margin. Gross income excludes costs related to selling, administration, taxes, and other expenses. (GOV.UK, n.d)

A non-UK resident is liable to pay UK tax on UK-source income. (GOV.UK, n.d)

An individual who is resident but non-UK domiciled can be granted UK tax relief for the number days worked outside of the UK in their year of arrival and the two subsequent tax years, if the individual is taxed in the UK on the remittance basis, this is called Overseas Workday Relief. (GOV.UK, n.d)

Where the remittance basis is claimed, a resident but non-UK domiciled natural person is liable to pay UK tax on foreign income and capital gains only to the extent that they are remitted to the UK. UK source income and UK capital gains are taxed as normal on the arising basis i.e. in the year in which they arise. (GOV.UK, n.d)

The recent changes modify the rules for:

- non-UK domiciled individuals who have been resident in the UK for 15 out of the previous 20 tax years; and,
- those resident in the UK who were born in the UK with a UK domicile of origin and who now assert a foreign domicile of choice.

In both cases, the remittance basis of taxation is no longer available from 6 April 2017 but the effect on the globally mobile seconded population is expected to be small (albeit for those in the latter category, the impact could be materially adverse). (GOV.UK, n.d.)

For example, for overseas workday relief purposes, employment income (salary) can generally be apportioned between UK and non-UK duties based on workdays.

But overseas workday relief is only available for the first 3 years of UK tax residency and once overseas workday relief is no longer available, salary can no-longer be apportioned into UK source and foreign source based on workdays – all salary from a UK employer is treated as UK source. (FKGB, n.d)

Once overseas workday relief is no longer available, only salary from an employment with a foreign employer where the duties of that employment are performed wholly overseas can be treated as foreign source for the remittance basis. (FKGB, n.d)

In the past this led to “dual contracts” being adopted. Since 6 April 2014, specific restrictions have been introduced to prevent avoidance in this area. (Brady, 2019)

Unfortunately international hiring-out of labour is sometimes misused to avoid paying personal income taxes. For example, a local employer may decide to employ foreign labour for one or more periods of less than 183 days. They do this by recruiting individuals through a foreign intermediary (i.e. company), which purports to be the employer and hires out the labour. (Mohan, 2016)

This results in the individuals (generally non-tax residents) avoiding paying tax at source in situations where services are rendered in foreign countries that have a DTA in place.

If the non-resident meets the three conditions contained in the dependent personal services article dealing with income from employment of the relevant DTA and may claim exemption from taxation in the country where he is rendering the services. Thereby dodging tax in the country that they originate from, and the country that they were seconded to. (Brady, 2019)

The Organisation for Economic Cooperation and Development (OECD) has come up with certain criteria to establish who the real employer is. This is to limit and eliminate the abuse in situations where a non-resident employee works in another country for less than 183 days and does not have to pay tax in the source country because they are seen as being employed by a non-resident employer. The distinction in law is not between a 'contract of services' and a 'contract for services'. The distinction is between a contract for the rendering of services (ie an employment contract), known in Latin as locatio conductio operarum, and a contract for the letting and hiring of a job of work (where the worker is an independent contractor), known in Latin as locatio conductio operis, Where the nature of the work done by the non-resident indicates an employment relationship with the entity receiving their services, the following criteria are used to determine whether the services are rendered in an employment relationship (contract of services) or whether services are rendered under a contract for the provision of services (contract for services):

- who has the authority to hire or fire that individual? And
- who bears the responsibility for the work produced by the seconded staff? Does the seconding entity bear the risk and responsibility for the results produced by the seconded employees and maintain discipline over the seconded employees' performance?

Resident juristic persons are taxable in the United Kingdom on their worldwide taxable profits while non-resident juristic persons are subject to UK corporation tax on the taxable trading profits attributable to a UK permanent establishment. The normal rate of corporation tax is 19%. Any other UK-source income received by a non-resident company is subject to UK corporation tax at the basic rate, currently 20%. (KPMG Global, 2020)

Chapter 3: Secondment Arrangements

3.1 Introduction

Secondment essentially means that an employee is transferred from one related employer to another on a temporary basis. The arrangement is in such a way that the employee will at the end of the secondment, 'return' to the original employer and will remain the formal employee of the original employer for the duration of the secondment. It can be an intra-company transfer within the same organization or between two unrelated business entities. It can be a domestic or overseas expatriate assignment. A secondment arrangement constitutes an arrangement where a resource performs the business activities of his original employer who carries the responsibility or risk for the results produced by that resource provided to another entity (OECD, 2014, C(15)-16).

Possible reasons for secondment include:

- career development
- gaining new skills or experience
- preserve employment specific benefits from the original employer, for example a pension or share option scheme
- increase revenue for the original employer
- providing staff for short-term projects
- providing cover for short-term absences
- avoiding redundancies
  (Laver,n.d)

3.2 The Importance of the contractual arrangements

A secondment agreement involves the home-country employer, the host-country employer, and mostly the employee and the employee has to work in the host country employer's premises. In this agreement, the terms of seconding (agreed service deliverables, together with the secondment terms and conditions) the employee from the home-country entity to the host-country entity are detailed. (Rosenthal, 2014.)

An employee can be a party to the agreement for different reasons, a secondment agreement is not an assignment letter and should not be used as one. It is usual practice for employers to give employees a separate assignment letter detailing the terms of a cross-border assignment. In many cases, a secondment agreement will involve only the two employing entities and can cover all employees who are on assignment to each jurisdiction. (Rosenthal, 2014.)

The employer and employee will have to go over the terms of the secondment agreement and consider how those terms will impact the employee's existing contract of employment in the home country. The secondment agreement must make it clear that its terms will take precedence over those in the employee's contract of employment. However, the employee will have to take cognisance that all the terms and conditions of his or her contract of employment will be otherwise unaffected for the duration of the secondment.

In the process to determine who carries any liabilities relating to the secondee it is vital to distinguish their status, that is whether they are an employee or an independent contractor of the seconder and/or the host. This will determine which statutory employment rights will come into effect, how any remuneration is taxed. (Bull, Lewis, 2013, 8)

The original employer is vicariously responsible to carry the liability for the wrongful acts of its employees, even for the duration of the secondment to another organisation. However, the host employer may also be liable for the secondee's actions despite the fact that they remain employed by their original employer, depending on the circumstances - for example, who had control of the secondee at the time. (Bull, et, al. 2013, 8)

3.3 Income tax implications in the UK on secondments to the UK

The criteria used to determine who the real employer for tax purposes is, the services and secondment agreement should differ from how the arrangement between the parties plays out in reality. The services agreement between the original employer and the host country entities should make clear reference to the employee selection criteria, supervision, period of the secondment, renewal of the secondment and notice of termination of the secondment. It should mention that the home country employer will remain responsible for the performance appraisal of the secondee. (Netlawman, n.a, 2020)

It is clear that, although there are business imperatives for mobilising a workforce, this should be considered in light of the personal and corporate income tax considerations in both countries. Failure to do so will prevent a successful cross-border employment.

An employee of an overseas company who attends a temporary workplace in the UK for a period of up to 24 months may be able to obtain relief for the cost of travel to and from that workplace, accommodation and subsistence attributable to attendance at that workplace. This is known as “Detached Duty Relief”, owing to their duties being detached from their normal location of their employment. (ENS, n.a 2015)

The non-resident employee to the UK and who renders services in that country, will be liable to pay tax in the UK (Bull et al, 2013, 8) unless –

- there is a Double Taxation Agreement between the UK and the employee's resident country;
- the employee does not spend more than 183 days in the UK; and
- its actual employer does not have a permanent establishment in the host country, which is covering the costs of the employee in the UK.

In order to claim detached duty relief, the secondment must be part of the duties of continuing employment rather than the commencement of a new employment. The relief is ideal for existing staff of an overseas company who can be seconded to the UK operation for a period which is not expected to exceed 24 months. The existing contract of employment with the overseas employer is still maintained and the expectation is that the employee will return to the overseas employer after the period of secondment. (Clark,n.d)

Once it has been established that the secondment constitutes continuing employment, relief can only be obtained if it is expected that the employees' duties in the UK will last no longer than 24 months. If at any point during this 24 month period the expectation changes, such that the duration of stay is likely to exceed 24 months, the tax relief is lost from the date of the change in expectation- not from the end of the 24 month period. (Clark,n.d)

HMRC does allow flat rate payments to cover an employee's subsistence while on temporary relocation to a different office. These have been subject to various changes over the last few years and given the secondment to the UK is not exactly what these benchmark rates are supposed to cover, there is limited clear guidance as to exactly what would apply to an overseas employee sent to the UK under this relief. (Clark,n.d)

Costs of all business travel associated with the secondment including reasonable subsistence and accommodation costs are allowable expenses, in full, against the employees income, or if paid for by the employer, are not taxable as earnings or benefits of the employee.

In some situations, allowances for employees' accommodation and subsistence are granted by employers. These can be possible to be paid without tax, but permission may need to be sought from HMRC and a different type of payroll scheme maybe required. It is preferable, if somewhat more administratively burdensome, to pay or to refund specific receipted expenses. (Clark,n.d)

The original employer will continue to pay the secondee's remuneration (in particular income tax, pension contributions and/or medical aid contributions) as per normal business practice. If the secondment is a commercial secondment arrangement then the host will usually reimburse these costs in a form of a secondment fee. (Bull, Bill, 2013, 8.)

Tax is usually the largest part of the cost associated with secondments. Careful planning can reduce the overall cost while taking away some uncertainty for the employee.

Tax issues in multiple jurisdictions can arise when seconding employees overseas, but these should not be daunting provided that they receive due consideration. The employer should give thought to whether or not the employee should be 'tax equalised'. Under tax equalisation, the employee is put in no better or worse position, tax wise, as a result of taking up a secondment. The employee will remain responsible for tax on his or her home country compensation and benefits package. The employer will meet the tax liabilities arising on assignment-specific benefits like accommodation and school fees as well as additional taxes due to higher tax rates in the host country. Clearly, where the host country has higher tax rates than the home country, equalising will potentially add to the employment costs. Employers will need to take into consideration that, although taxes may be higher, some countries provide tax breaks to secondees, which help mitigate the tax costs. (Bull, et al. 2013)

The terms of any tax equalisation policy are usually set out in the employer's assignment policy. It is crucial to clarify what elements of the compensation and benefits package are covered by tax equalisation, especially where long-term incentives are provided, and employers may want to consider a robust policy with regard to taxes arising in the host location on personal income.

3.4 Tax implications in South Africa on secondments to South Africa

Where South Africa is the host, and the non-resident renders services in South Africa, the South African host may be liable to account for the non-resident's tax liability in South Africa.

Secondees may experience problems with cash flow and double taxation as a result of different tax regimes in the host and home countries.

These may include:

- The host country may not tax the same items of income in the same fiscal year.
- Different tax rates, allowances and deductions may apply.
- There may be preferential tax treatment for some benefits in kind.
- There may not be comparable tax treatment in the host country in relation to certain benefits (e.g., home country pension fund contributions).
- While on assignment secondees receive taxable compensation that they would not otherwise have received. Consequently, they have more tax to pay than they would have paid had they remained at home.

To prevent double taxation, secondees' remuneration will need to be apportioned to exclude the portion that relates to services rendered outside South Africa from South African taxable income. However, if the services rendered outside South Africa by the secondee are regarded as incidental, then the source of the income will be fully South African.

SARS accepts that the correct method to apportion income for services rendered, both in South Africa and abroad, is to consider the number of workdays in each jurisdiction. Workdays do not include weekends, public holidays or leave days.

Employers generally provide accommodation for seconded employees, which is a taxable benefit. A concession is provided under paragraph 9(7A) and (7B) of the Seventh Schedule to the Income Tax Act (subject to certain conditions): no taxable value is placed on the use of accommodation provided by the employer to the secondee for a period not exceeding two years from the date of arrival in South Africa to commence employment. The tax-free amount is, however, limited to R25 000 multiplied by the number of months during which the accommodation was provided.

In a commercial secondment, the host employer will normally pay a secondment fee to the original employer at regular agreed intervals for the duration of the secondment. This fee may be an amount which covers the original employer's costs or, probably, include a profit mark – up element. The secondment fee will attract VAT if the original employer is a registered vendor for VAT. The secondment agreement should make provision for amendments in the fee during the secondment period, in particular to reflect any increases in the secondee's salary. (Bull et al, 2013, 7)

Chapter 4: Creation of a permanent establishment from a secondment arrangement

4.1 Introduction

The PE concept came into existence in the nineteenth century under German domestic law to prevent double taxation by Prussian municipalities. In 1927, the League of Nations adopted the PE concept in its first draft convention on double taxation, which included examples of PEs such

as branches, factories and agencies and offices. These rules were included in the League of Nations' first Model Tax Convention in 1943. The PE rules as promulgated by the League of Nations were embodied in the first report of the OECD, which was issued in 1958 and subsequently included in the OECD Draft Taxation Convention on Income and Capital that was succeeded by the 1977 Model Tax Convention. (Ogutu, 2009, 775)

Article 7(1) of the OECD Model Tax Convention, which lays down the basic rule for taxation of PEs, states:

> 'The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.'

If there's no PE, the business profits generated from the source country by a non-resident are not taxable there and are taxable only in the non-resident's country of residence.

In the event that PE is created in the source country, that country not only is granted the right to tax the business profits attributable to the PE but also its right to tax takes precedence over the residence country's right to tax those profits. The residence country becomes obliged either to exempt the business profits attributable to the PE in the source country or to provide a credit for the source country tax. The PE idea therefore plays two vital roles in international tax law.

In the United Kingdom, a permanent establishment is formed if the non-resident company has a fixed place of business in the United Kingdom through which the whole or part of the business of the company is undertaken; or has an agent that is acting on behalf of the company habitually exercising authority to do business on behalf of the company in the United Kingdom. (e-Residency 2020)

First, the concept of a permanent establishment is used as a condition that must be satisfied in order for a country to tax a non-resident on taxable business profits derived from sources in that country. Secondly, the concept also plays a role in apportioning tax revenues from cross-border business transactions between the country in which the income is generated and the country in which the owners of the business are residents. These two roles are clearly set out in the following extract from par 1 of the Commentary on art 7: When an enterprise of a resident country carries on business in the foreign country, the authorities of that foreign country have to establish two fundamental things before tax is levied on the profits of the enterprise: the first is whether the enterprise has a permanent establishment in the foreign country and if the profits on which that permanent establishment should be taxed. Since the entire profits of enterprise cannot be in the source country but only the profits attributable to the PE, this requires a determination of the amount that should be taxed as arising from the activities of the PE.

4.2 Double Tax Agreement

Countries enter into double tax agreements (DTA) to regulate the way in which each country accounts for tax in their own domestic legislation. The tax treaty lays down the rules for the taxation of different types of passive income, such as dividends or interest income, thereby providing assurance to taxpayers with regard to the state of their tax affairs. A double tax agreement facilitates in determining whether the country a taxpayer is resident in or the country the income is sourced in has the right to tax a particular type of income. (Mukumba, 2019)

In a South African context, s 108 of Income Tax Act, which deals with the prevention of or relief from double taxation, authorises the conclusion of a DTA and provides in subsection 2 that as soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act.

Section 108(2) clarifies that a DTA will apply as if enacted in the Income Tax Act, and as such, a DTA becomes part of domestic law. However, there is no clarity provided in s 108 where there is a conflict between the domestic law and the DTA.

The recent judgment of the Court of Appeal (England and Wales), Civil Division in the case of *Fowler v Revenue and Customs Commissioners* [2018] STC 2401 deals with how domestic tax law is to be applied to determine the meaning of an article in a DTA. The court was called to determine whether the consequences of a deeming provision in United Kingdom law extended to the interpretation of a DTA.

The relevant facts, key issues, arguments made by the taxpayer, decision of the Court of Appeal including the minority and majority judgments, are summarised below.

4.3 Case Law

4.3.1 Introduction

Tax cases play a large part in the interpretation of tax legislation since many of the terms mentioned in the Income Tax Act are not defined. Knowing the basic principles of taxation and the associated tax cases, is a prerequisite for effective tax planning.

4.3.2 Facts of Martin Fowler Case

During the 2011/12 and 2012/13 tax years, Martin Fowler, a qualified diver (Taxpayer), undertook diving engagements in the United Kingdom continental shelf waters. The Taxpayer was a tax resident in South Africa but earned income from activities within the jurisdiction of the United Kingdom. An issue arose as to whether, under the DTA concluded between South Africa and the United Kingdom which came into force on 17 December 2002 and based on the OECD MTC (SA/UK DTA), he was liable to be taxed by South Africa or the United Kingdom on the income arising from those activities.

It is common cause that if the Taxpayer were found to be self-employed, such income would constitute business profits within the meaning of article 7 of the SA/UK DTA and would be taxed in South Africa. Alternatively, if he was found to be earning income from employment, article 14 would give the taxing rights to the United Kingdom.

The case was first heard in the First Tier Tribunal, as a preliminary issue, where the Taxpayer was found to be self-employed. This decision was reversed by the Upper Tribunal, which decision the Taxpayer appealed against to the Court of Appeal.

The Court of Appeal was called to interpret the provisions of the SA/UK DTA to determine whether the Taxpayer had earned 'Business Profits' under article 7 or 'Income from Employment' under article 14. Essentially, the court was required to determine which country had the right to tax the Taxpayer's diving income.

Article 7 of the SA/UK DTA provides that the profits of an enterprise (ie the carrying on of any business) of a Contracting State shall be taxable only in that State unless the enterprise carried on business (ie includes the performance of professional services and other activities of an independent character) in the other Contracting State through a permanent establishment situated therein. The Taxpayer did not have a permanent establishment in the United Kingdom and accordingly, article 7 would allocate the right to tax him to South Africa, if he was in fact self-employed.

Furthermore, article 7(6) provides that

> 'where profits include items of income or capital gains which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.'

This provision has the effect that if article 14 were to apply, article 7 would not.

Article 14 applies to income from employment and provides that salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of employment shall be taxable only in that State unless the employment is exercised in the other Contracting

State. The Taxpayer's diving activities were exercised in the United Kingdom, and as such, to the extent that it was found that those activities generated remuneration in respect of employment, the United Kingdom would have a right to tax such employment income.

As article 14 supersedes article 7, if the income constituted income from employment it could not be business profits. The term 'employment' is however not defined in the SA/UK DTA and therefore the case turned on the interpretation of this word. Article 3(2) of the SA/UK DTA followed the OECD MTC and provided that where a term is undefined, it is to be read with the meaning it has under the United Kingdom domestic tax law.

The term 'employment' is partially defined in s4 of the Income Tax (Earnings and Pensions) Act 2003 (2003 Act) to include any employment under a contract of service, contract of apprenticeship and in the service of the Crown. On this point, the Court of Appeal assumed, for purposes of the preliminary issue, that the Taxpayer carried out his diving activities under a contract of service, thereby falling within the definition of 'employment'.

4.3.3 Taxpayer's arguments in Martin Fowler Case

The Taxpayer contended that in order to determine which country has taxing rights, regard should be had to s15 of the Income Tax (Trading and Other Income) Act 2005 (2005 Act) which contains provisions that deem earnings from diving activities, to be the carrying on of a trade within the United Kingdom, instead of such income being treated as employment income. The Taxpayer argued that such income would therefore fall squarely within article 7 of the SA/UK DTA on the basis that the income arose from the carrying on of an enterprise. Accordingly, South Africa and not the United Kingdom had the right to tax the income from the diving activities. (Mukumba, 2019)

4.3.4 Decision of the Court of Appeal in Martin Fowler Case

Although the Lord Justices reached two different judgments, they all endorsed the approach to the law taken by the minority per Lewison LJ. Lewison LJ first made a distinction between what is being taxed and who has the right to tax it. As set out above, article 3 of the SA/UK DTA provides guidance with regard to the interpretation of the DTA and the determination of which category a particular income falls into.

Having reference to the provisions of article 3(2) of the SA/UK DTA, the nature of the income from the diving activities would be determined in terms of the United Kingdom domestic law (ie by the provisions of the 2003 Act, read with the provisions of the 2005 Act).

Section 15 of the 2005 Act applies where a person engages in seabed diving activities in the United Kingdom or its continental shelf area and income would have been taxable as employment. Section 15(2) goes on further to provide that the performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the United Kingdom.

The minority and majority judgments differed on the consequences of this deeming provision, as discussed in more detail below.

Lewison LJ's approach to interpreting the deeming provision was based on the *House of Lords' judgement Marshall (Inspector of Taxes) v Kerr [1994] STC 638*, quoting from page 649:

> "For my part I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so."

Essentially, the above quote led Lewison LJ to find that:

> 'what that article [3(2)] does is to import into art 14 the UK tax law definition of 'employment' which is a word otherwise undefined by the treaty. For the purposes of UK tax law, the definition of 'employment' is to be found in s 4 of the 2003 Act. I cannot see anything in s 15 which changes the meaning of that defined term.'

Lewison LJ also noted that s 15 of the 2005 Act was a product of a ‘tax rewrite’ which was not intended to alter the law, but rather only sought to modernise the language and make tax laws more accessible. He concluded that s15 of the 2005 Act alters how employment income is taxed in the United Kingdom, rather than changing what is being taxed. Therefore, the activities undertaken by the Taxpayer still constituted employment activities and all that was changed by deeming provision was the treatment of that income by revenue authority. Henderson LJ concluded that if the Taxpayer was employed as a diver during the relevant tax years, the United Kingdom and not South Africa had the right to tax that income under article 14 of the SA/UK DTA.

Henderson LJ and Baker LJ found that s15(2) of the 2005 Act requires that the performance of the duties of employment be treated as the carrying on of a trade in the United Kingdom ‘for income tax purposes’. That was found to mean ‘for all income tax purposes under UK law’, including the treatment of the remuneration received by the Taxpayer.

The Justices stated that the earnings from the Taxpayers’ employment were to be regarded as profits of the trade which he was deemed to be carrying on. By virtue of s 6(5) of the 2003 Act, such earnings fell within the charge to tax relating to trading income under the 2005 Act and are not taxed as employment income.

Both judgments adopt *Marshall (Inspector of Taxes) v Kerr* as authority for the consequences of deeming provisions. Henderson LJ emphasised the last sentence of the passage quoted by Lewison LJ and reinforced the consequences of a deeming provision by quoting Lord Asquith of Bishopstone in East End Dwellings Co Ltd v Finsbury BC [1951] 2 All ER 587 where at page 599 he stated:

> ‘The statute says that one must imagine a certain state of affairs. It does not say that, having done so, one must cause or permit one’s imagination to boggle when it comes to the inevitable corollaries of that state of affairs.’

It followed therefore that the activities of and income earned by the Taxpayer were deemed to not constitute employment activities or income and rather must be treated under the tax laws of the United Kingdom as trading activities and income. Meaning that the income fell to be taxed under article 7 of the SA/UK DTA by South Africa and essentially a permanent establishment was not created.

4.3.5 Facts of AB LLC and BD Holdings LLC v CSARS Case

This case was selected as it clearly articulates how a permanent establishment can be created specifically based on case law and there's some similarities in the SA/UK DTA and the SA/USA DTA.

This case was heard in February 2015, the Tax Court had to determine whether AB LLC and BD Holdings LLC (AB and BD) had formed a permanent establishment in South Africa, and as a result thereof, were subject to tax in South Africa. The case involved two companies incorporated in the United States of America and the court therefore had to take into account the provisions of the DTA concluded by South Africa and the United States of America.

Article 7(1) of the DTA concluded by SA and the USA provides that the profits of an enterprise of the USA shall be taxable only in the USA, unless that enterprise conducts business in South Africa through a permanent establishment located in South Africa. Furthermore, the DTA provides that where business is carried on through a permanent establishment, the profits of the enterprise may be taxed in South Africa, but only to the extent that they are attributable to that permanent establishment.

Article 5(1) of the DTA in turn provides as follows:

> 'for the purpose of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.'

Article 5(2) of the DTA provides that the concept 'permanent establishment' includes especially-

> '(k) the furnishing of services, including consultancy services, within a contracting state by an enterprise through which employees or other personnel engaged by the enterprise for such purposes, but only if activities of that nature continue (for the same or connected project) within that state for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the taxable year concerned.'

The court had to decide how the DTA should be interpreted and whether it was necessary for AB and BD to have met the requirements of both Articles 5(1) and 5(2)(k) of the DTA.

The taxpayer contended that it is necessary that a permanent establishment be created first under Article 5(1) and only once that has occurred, is it then necessary to take account of the provisions of Article 5(2)(k) of the DTA. SARS on the other hand, argued that if AB and BD fell within the provisions of Article 5(2)(k), a permanent establishment exists and it is not necessary that AB and BD meet the requirements of Article 5(1) of the DTA.

The court also had to consider the manner in which the 183 days in any 12 month period commencing or ending in the taxable year concerned should be determined under Article 5(2)(k). AB and BD contended that the 183 day requirement found in Article 5(2)(k) must be for a '12 month period commencing or ending in the taxable year concerned'. Thus, when an entity spends less than 183 days in any 12 month period commencing or ending in a taxable year in South Africa, then that entity cannot be said to have created a permanent establishment in this country.

AB and BD were present in South Africa from February 2007 and the third phase of the consulting assignment ended during May 2008. The Judge made the point that since 1 May 2008, no employees of AB and BD were present in South Africa and that the Appellant's financial year commenced on 1 January 2007 and ended on 31 December 2007. AB and BD accepted that it had been present in South Africa for more than 183 days during the 2007 tax year.

4.3.6 Taxpayer's arguments in AB LLC and BD Holdings LLC v CSARS Case

The taxpayers argued that insofar as the 2008 tax year is concerned, SARS could not count any of the days already taken into account when determining the days that it was present in South Africa during the 2007 tax year. On the basis that AB and BD were only in South Africa from 1 January 2008 to 1 May 2008, it was not in South Africa for 183 days during that tax year. It was therefore argued that SARS could not tax the profits derived during that tax year. As far as the 2009 tax year was concerned, the court made the point that it was common cause that AB and BD had no presence in South Africa during that year. The taxpayers therefore argued that it was only in 2007 that it met the 183 day rule as set out in Article 5(2)(k).

SARS contended that the presence of AB and BD in South Africa for the 2008 and 2009 years was established beyond doubt. SARS contended that as the Appellant was in South Africa during the calendar year 1 January 2007 to 31 December 2007 and 1 January 2008 to 31 December 2008, it was in South Africa for two tax years, that is 1 March 2007 to 28 February 2008 in respect of the 2008 tax year and 1

March 2008 to 28 February 2009, that is the 2009 tax year. At paragraph 47, the court indicated that the 183 - day period should be calculated forwards from 1 March 2007 to 28 February 2008 as this is the commencing of the fiscal year and then again backwards from 28 February 2009 to 1 March 2008, as that is in respect of the ending of the fiscal year.

SARS conceded that this results in some days being double counted. SARS' counsel contended that SARS is not only allowed by the treaty to double count the days, but that it was actually contemplated by the parties to the DTA and in support thereof drew attention to the OECD commentary which deals with this point. Unfortunately, the commentary referred to Article 15 of the Model Tax Convention on Income and on Capital which deals with income from employment and does not in any way refer to the determination of whether a permanent establishment has been created as envisaged in terms of Article 5(2)(k). It is therefore questioned whether it is appropriate to rely on commentary dealing with income from employment in determining how Article 5(2)(k) should be interpreted.

4.3.7 Decision of the Court on AB LLC and BD Holdings LLC v CSARS Case

Vally J, in his judgment handed down on 15 May 2015, reached the conclusion at paragraph 30 that Articles 5(1) and 5(2)(k) cannot be read disjunctively. He expressed the view that as a result of the usage of words 'includes especially' Article 5(2)(k) of the DTA should be read as specifying those specific activities which will be regarded as creating a permanent establishment in South Africa. The Tax Court reached the decision that taking account of the number of days spent by AB and BD's staff in South Africa, it met the time requirement specified in Article 5(2)(k) of the DTA and for that reason a permanent establishment had been created in South Africa. The court also reached the conclusion that AB and BD had a fixed base in the boardroom of its client in South Africa, and had therefore established a fixed place of business in South Africa while rendering services to its client in South Africa.

On paragraph 37 of the judgment, the court refers to the interpretation of Articles 5(2)(k) and 5(1) as set out in the Technical Explanation, which document the court viewed as offering an insight into the understanding of the signatories to the DTA, namely South Africa and the United States. It is important to note that the Technical Explanation issued on the South African / United States DTA is not available on the SARS website and can only be located on the website of the Internal Revenue Service. There is no indication in the Technical Explanation itself or in any other documentation that the Technical Explanation has been accepted or adopted by the Commissioner: South African Revenue Service. The introductory paragraph of the Technical Explanation states as follows:

> “the Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention.”

The court refers to the fact that the Technical Explanation makes it clear that in considering the furnishing of services by an enterprise as dealt with in Article 5(2)(k) the analysis or interpretation accorded to the place of work set out in Articles 5(2)(a) to 5(2)(f) is not applicable. It indicates further that the Technical Explanation states that in the case of furnishing of services this does not have to occur within a ‘fixed place of business’ (Article 5(1)). Thus, once the provisions of Article 5(2)(k) are met, there is no need to further examine whether the provisions of Article 5(1) have also been met to determine whether the existence of a permanent establishment has been proved.

It would appear that the court took the view that the Technical Explanation on the DTA under consideration is binding in South Africa, but this does not appear to be the case in other countries. In the Canadian case of *Haas Estate v The Queen* [1999] 53 DTC 1294 Margeson JTCC states at paragraph 30 as follows:

The Federal Court of Appeal [in Canada (Attorney General) v Kubicek Estate 1997, 51 DTC 5454] observed that: ‘There is no international tradition or procedure for an exchange of subsequently bargained documents as determinative of treaty interpretation. The Technical Explanation is a domestic American document. True, it is stated to have the endorsation of the Canadian Minister of Finance, but in order to bind Canada it would have to amount to another convention, which it does not. From the Canadian viewpoint, it has about the same status as a Revenue Canada interpretation bulletin, of interest to a Court but not necessarily decisive of an issue.

It is unfortunate that the court did not deal with the status of the Technical Explanation in South Africa and on what basis the interpretations set out therein should bind the courts of this country. Furthermore, the court did not refer to the rules of interpretation of treaties as set out in the 1969 Vienna Convention on the Law of Treaties. It is clear that the Technical Explanation has not been adopted as part of the DTA concluded with the United States in conformity with the provisions of the Constitution or the provisions of the Income Tax Act 58 of 1962 (the Act), itself.

The question that does arise is how many similar documents or memoranda of understanding exist between SARS and other revenue authorities insofar as the interpretation of DTA's are concerned.

In the case of *Ben Nevis Holdings (Ltd) and Another v Commissioner for HM Revenue and Customs* [2013] EWCA CIV 578, the court indicated that memoranda of understanding concluded by contracting states may have an important bearing on the position of taxpayers and that it is in the interest of fairness to taxpayers that such memoranda of understanding should be readily available to the public.

As indicated above, the Technical Explanation is only available on the website of the Internal Revenue Service and not SARS' web pages, and if SARS wishes the public of South Africa to be aware of the Technical Explanation, it should, as a minimum, be published on the SARS website with a clear indication as to the status that it has in the law of South Africa.

It must be remembered that Article 5(1) of the DTA, in defining a permanent establishment, refers to a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'. The court expressed the view that it is not necessary that the non-resident carries out all of its business from the fixed place of business which is established in South Africa. The court reached the conclusion that a permanent establishment is created where AB and BD performs only some of its obligations in terms of a contract concluded with its client, and even if it concluded part of its business from its client's boardroom. The court also referred to the manner in which the 2009 assessment should be dealt with. The court accepted that AB and BD did not have a presence in South Africa during any part of the 2009 calendar or fiscal year. The point was made that the amount it earned in 2009 related to a success fee which it received in accordance with the particular clause of the contract concluded with its client.

The court reached the view that the success fee constituted deferred income for the February 2007 to May 2008 period and that it was therefore covered by Article 7(1) of the DTA, which provides that the profits of an enterprise made in the state where it held a permanent establishment shall be taxable in that state if the profit was attributable to that permanent establishment.

The court therefore reached the conclusion that the success fee was directly related to the permanent establishment and was therefore correctly assessed to tax thereon.

In assessing AB and BD to tax in South Africa, SARS levied tax on the fees derived by AB and BD in South Africa, after deducting therefrom attributable expenditure and imposed additional tax of 100% and levied interest on the underpayment of provisional tax in accordance with section 89*quat*(2) of the Act. The court reached the decision that the additional tax was not disproportionately punitive and therefore dismissed the appeal against the additional tax.

In so far as the imposition of interest is concerned, the court expressed the view that AB and BD should have familiarised itself with the taxation laws of the country within which it conducts its operations, and for that reason it was decided that AB and BD had been negligent in not seeking advice regarding the tax consequences of the contract concluded with its client. The court therefore came to the conclusion that SARS was correct in imposing interest on the underpayment of provisional tax.

Based on the above case, which admittedly deals with the interpretation of articles contained in the SA and USA DTA, it is important that non-residents rendering services to clients in South Africa evaluate whether they will create a permanent establishment in South Africa, thereby triggering income tax on the profit attributable to the services rendered in South Africa.

Furthermore, if the non-resident creates an enterprise as envisaged under the provisions of the VAT Act, it would also be necessary to register for VAT purposes and charge VAT on the fees received from the resident client and pay that to SARS. Furthermore, where persons from abroad are sent to South Africa to render the services that may, depending on the circumstances and the provisions of the DTA in question, give rise to the non-resident entity being required to register as an employer in South Africa with the obligation to withhold and deduct PAYE from amounts paid to persons sent to South Africa to render services here.

Clearly, any South African tax paid by the non-resident entity, would, under the terms of the DTA, be recognised as a credit claimable against tax paid in the home jurisdiction of the entity rendering the services in South Africa. Non-resident employees who become liable to tax in South Africa should also be entitled to claim such tax as a credit in their home jurisdiction under the DTA in question.

4.4 OECD and the BEPS Report

In terms of Article 7(1) of the OECD's Model Tax Convention on Income and on Capital (Model Tax Convention), a Contracting State will only have taxing rights in respect of the business profits of a foreign enterprise that is a resident of another Contracting State if the enterprise has a "permanent establishment" (PE), as defined in Article 5, in that State to which such profits are attributable.

Article 5(5) of the Model Tax Convention provides that a person (other than an independent agent, as discussed below) acting on behalf of an enterprise will be deemed to be a PE of the foreign enterprise if, *inter alia*, he has and habitually exercises in the host country a general authority to conclude contracts on behalf of the enterprise, unless his activities are limited to certain specific exclusions, such as the purchase of goods or merchandise for the enterprise.

Article 5(6), in turn, provides that an enterprise shall not be deemed to have a PE merely because it carries on business in the Contracting State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

It is therefore possible for a non-resident enterprise to have a PE in a Contracting State, despite not having a "fixed place of business", if a dependent agent has and habitually exercises an authority to conclude contracts on its behalf. The OECD Commentary provides guidelines to determine whether an agent is independent.

The OECD Commentary on Article 5(5) notes that the phrase “authority to conclude contracts in the name of the enterprise” does not only apply to an agent who enters into contracts literally in the name of the enterprise. Furthermore, it notes that a lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. Where the agent is authorised to negotiate all elements and details of a contract in a way which is binding on the foreign enterprise, even if the agreement is signed by another person in the State where the enterprise is resident, the agent can be said to exercise the authority envisaged in Article 5(5) of the Model Tax Convention.

The BEPS Report proposes new wording for, *inter alia*, Article 5(5), in terms of which an enterprise will, unless an exclusion applies, be deemed to have a permanent establishment where a seconded employee acts on its behalf in a foreign country, and in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts –

- are in the name of the enterprise, or
- for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or
- for the provision of services by that enterprise (our emphasis).

The proposed OECD Commentary notes that if the above conditions are met, the person’s actions on behalf of the enterprise will be sufficient to conclude that the enterprise participates in business activity in the state concerned, since those actions go beyond mere promotion or advertising. It is stated that a contract may be concluded without any active negotiation of the terms of that contract and that a contract may be concluded in a State even if the contract is signed outside that State. The test will focus on the substantive activities taking place in a State to include scenarios where a contract is concluded directly as a result of such activities.

Non-residents of South Africa are subject to South African tax on income that is derived from a source within or deemed to be within South Africa. Whilst determining the “source” of income is a factual enquiry, if a non-resident company sells products to clients in South Africa with the assistance of a South African-based sales team, the sales team may result in a conclusion that at least a portion of the non-resident's income is derived from a source within South Africa. It should then be considered whether an applicable double tax agreement (DTA) provides any relief in respect of any such South African sourced income. This should be the case if the non-resident does not have a PE in South Africa to which its business profits or a portion thereof are attributable.

If the recommendations of the BEPS Report are implemented in their current form and are incorporated into DTAs entered into by South Africa, in determining whether a dependent agent would trigger a permanent establishment for a foreign enterprise, regard should be had, *inter alia*, to:

- Whether the activities of the dependent agent constitute mere advertising or promotion, or whether they constitute, or result directly in, the conclusion of contracts on behalf of the foreign enterprise.
- Whether the contracts eventually concluded are materially modified by the foreign enterprise offshore from the form that may have been proposed by the dependent agent.
- Whether the dependent agent plays the principal role leading to the conclusion of such contracts.
- Whether the conclusion of such contracts takes place repeatedly or merely in isolated cases.

If the South African sales team creates a permanent establishment for the non-resident company in South Africa, that company will be liable for South African tax at a rate of 28% in respect of its taxable income, which is essentially the income attributable to such PE, taking into account the functions and risks of the permanent establishment, less permissible deductions.

A foreign company generates revenue from rendering professional services to a South African company in South Africa must consider whether, as a result of rendering such services, the foreign company will create a permanent establishment in South Africa. The reason why this becomes important is because South Africa will, under the provisions of a Double Tax Agreement (DTA) concluded with the UK be entitled to subject that foreign entity to tax on the profit attributable to that permanent establishment created in South Africa.

The current definition of permanent establishment in the Income Tax Act is based on the definition developed by the Organisation for Economic Co-operation and Development (OECD). A permanent establishment is defined in paragraph 1 of Article 5 of the OECD Model Tax Convention (OECD MTC) as ‘a fixed place of business through which the business of an enterprise is wholly or partly carried on’. As per paragraph two of Article 5, it specifically includes a place of management, a branch, an office, a factory, a workshop and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. It also includes a building site or construction or installation project which lasts for more than 12 months.

Specifically excluded from the aforementioned definition, in paragraph 4 of the OECD MTC, is the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise and the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.

Paragraph five of Article 5 of the OECD MTC goes on to provide that ...where a person – other than an agent of independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise ....

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

A juristic person is resident in South Africa if it is incorporated, established, or formed in South Africa or has its place of effective management in South Africa. However, a company that is deemed to be exclusively resident in another country in terms of a double taxation agreement (DTA) is excluded from SA residency. (Interpretation Note 6 (Issue 2) 2015)

In terms of an Interpretation Note 6 (Issue 2) 2015, the place of effective management is regarded as the place where key management and commercial decisions that are necessary for the conduct of its business as a whole are, in substance, made. South Africa does not tax non-residents on the basis of having a permanent establishment in South Africa, but non-residents are subject to income tax in South Africa on income derived from a South African source. The primary exception to this rule is in relation to capital gains, where non-residents are subject to tax on assets attributable to a permanent establishment in South Africa.

If an individual finds that he or she spends longer time than the intended time in a jurisdiction there could be the situation where the individual can create a sufficient presence to trigger a taxable presence e.g. a branch or agency under domestic law or a permanent establishment under a double tax treaty. Many businesses operate across multiple jurisdictions and expect their employees to spend time throughout their careers in one or more international offices. The business reasons for promoting a mobile international workforce are clear, but consideration of the employment law implications of international postings and secondments is vital if employers are to avoid being unwittingly caught out by local rules. (Mekgoe, et, al. 2020.)

Where an employee is deployed to a new business in a new location, the employer should consider whether or not a permanent establishment is created, resulting in any income generated from the new location being subject to corporation tax in that jurisdiction. A permanent establishment may consist of a place of management, a branch, an office, a factory or a workshop. (Mekgoe, et, al. 2020.)

Chapter 5: Conclusion

The approach recommended by the Organisation for Economic Co-operation and Development (OECD)4 for attributing profits to PEs requires that a PE be treated as a separate legal entity.

Article 7(1) of the OECD Model Tax Convention, which lays down the basic rule for taxation of PEs, states:

> ‘The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.’

Thus, in the absence of a permanent establishment, the business profits derived in the source country by a non-resident are exempt from tax there and are taxable only in the country of residence.

It is therefore important that non-resident entities rendering services in South Africa carefully consider how to plan and structure their affairs in South Africa, so that they do not breach of the provisions of the Act read together with the UK DTA with South Africa.

Only recently, however, have requests for information begun to appear from SARS. The primary focus of the request for information appears to be whether a permanent establishment has been created in South Africa and thus profits attributable to that permanent establishment should have been subject to tax in South Africa.

This line of enquiry from SARS has most likely stemmed from its success in the recent South African tax case of *AB LLC / BD Holdings LLC v SARS*, Income Tax Case No. 1878. This case involved two corporations incorporated in the US providing consultancy services to a company incorporated in South Africa and the court had to decide whether these foreign entities had a permanent establishment in South Africa.

Article 5(1) of the tax treaty concluded between SA and the US (the Treaty) provides that:

> [f]or the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Further, Article 5(2) of the Treaty provides that the term "permanent establishment" includes especially:

> (k) the furnishing of services, including consultancy services, within a contracting state by an enterprise through which employees or other personnel engaged by the enterprise for such purposes, but only if activities of that nature continue (for the same or connected project) within that state for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the taxable year concerned.

The court had to interpret these provisions of the Treaty and, in particular, it had to decide whether the foreign service providers would only have a permanent establishment in South Africa if both the requirements in Article 5(1) and (2)(k) of the Treaty had been satisfied (as contended by the foreign service providers) or is it sufficient to merely satisfy the requirements in Article 5(2)(k) of the Treaty (as contended by SARS).

Ultimately, the court came to the conclusion that as soon as an enterprise's activities fall within the ambit of Article 5(2)(k), it becomes liable for taxation in South Africa and therefore there is no need for a further or separate enquiry as to whether the requirements of Article 5(1) have been met.

Interestingly, the court found support for its interpretation and application of these provisions of the Treaty in the technical explanation of the Treaty, which states that:

> ‘As indicated in the OECD Commentaries ..., a general principle to be observed in determining whether a permanent establishment exists (*except with respect to the furnishing of services under subparagraph (k))* is that the place of business must be 'fixed' in the sense that a particular building or physical location is used by the enterprise for the conduct of its business.’

If a taxable presence has been created in South Africa that could result in penalties and interest being imposed on the taxes that should have been paid or withheld. Non-resident service providers should carefully consider how best to structure their activities in South Africa in order to avoid adverse assessments being raised by SARS.

If the non-resident creates an enterprise as envisaged under the provisions of the VAT Act, it would also be necessary to register for VAT purposes, and charge VAT on the fees received from the resident client and pay that to SARS. Furthermore, where persons from abroad are sent to South Africa to render the services that may, depending on the circumstances and the provisions of the DTA in question, give rise to the non-resident entity being required to register as an employer in South Africa with the obligation to withhold and deduct PAYE from amounts paid to persons sent to South Africa to render services here. (Mekgoe et, al. 2020.)

Any South African tax paid by the non-resident entity, would under the terms of the DTA be recognised as a credit claimable against tax paid in the home jurisdiction of the entity rendering the services in South Africa. Non-resident employees who become liable to income tax in South Africa should also be entitled to claim such tax as a credit in their home jurisdiction under the SA/UK DTA. (Mekgoe et, al. 2020.)

In the taxation of non-resident business profits arising in South Africa, the provisions of double tax agreements in place, such as permanent establishment, are important in the determination of a country's right to tax the profits which arise. Non-resident business profits arising in South Africa will be subjected to income tax in South Africa when the business profits can be attributed to a permanent establishment in South Africa. Possibilities of double taxation occur, in instances where no agreements have been entered into with the non-resident's country of residence, a risk which the double tax agreements aim to mitigate with the conclusion of the agreements. The determination of a permanent establishment plays an important role in the taxation of non-resident business profits acting as a source rule that subjects profits of a non-resident attributable to a permanent establishment in South Africa, to income tax in South Africa. (Rosenthal, 2014.)

Most fixed place of business permanent establishments will arise where a business has a clearly identifiable base of operations such as a branch or office. However, the absence of these traditional bases of operations does not completely remove the risk of creating a UK permanent establishment through a fixed place of business. Organisation for Economic Co-operation (OECD) proposals published in 2012 and a number of non-UK cases have highlighted the possibility that an individual who works from home can be deemed to be working from a fixed place of business.

In the event that the employee does create a fixed place of business permanent establishment through home working, it may also be possible to apply the exception from creating a fixed place of business permanent establishment where the activities carried out by the employee are preparatory or auxiliary in relation to the business of the company as a whole.

In addition to the corporation tax consequences of having a UK permanent establishment, the income of the employees of the permanent establishment will also be subject to UK income tax from the first day of the existence of the permanent establishment. (Rosenthal, 2014)

As such it is imperative that companies with employees who regularly work outside of the UK and South Africa should obtain appropriate local advice in order to manage permanent establishment risks

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