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The Section 6*quin* Foreign Tax Rebate as an Incentive for South African Headquarter Companies

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ABSTRACT

The Katz Commission recognised that South Africa could benefit from multinational enterprise (MNE) groups headquartering in South Africa. MNE headquarter companies create jobs and attract highly skilled individuals who impact on the economies in which they reside. These highly skilled individuals are also high taxpayers in the countries where they provide their services.

South Africa has a number of attributes which would encourage MNE groups to headquarter in South Africa but the cost of doing business with the rest of Africa is high due to withholding taxes levied by African countries on technical and management fees. Countries with low tax rates attract MNE groups to headquarter in those countries as this effectively reduces the cost of doing business with the rest of Africa. The National Treasury introduced section 6*quin* of the Income Tax Act to provide effective relief to the South African taxpayer from double taxation on South African-sourced service fees charged to other countries and, in particular, other African countries.

An examination is conducted on the impact of double taxation and whether section 6*quin* provides more effective relief from double taxation compared to other double tax relief mechanisms available to the South African taxpayer which will incentivise MNE groups to headquarter in South Africa. An analysis is performed on the income tax forfeited by the South African Receiver of Revenue (SARS) in the National Treasury providing this incentive to South African headquarter companies compared to if the headquarter is relocated out of South Africa.

The results indicate that section 6*quin* provides a feasible solution to reducing double taxation on South African-sourced services provided to other African countries which incentivises MNE groups to headquarter in South Africa. If section 6*quin* is withdrawn from the South African Income Tax Act, MNE groups potentially will not headquarter in South Africa and seek low tax jurisdictions to reduce costs of providing headquarter services into Africa. This study indicates that the fiscus stands to lose more income tax if the MNE group headquarters outside of South Africa compared to the relief provided to the MNE group headquarter company in accordance with section 6*quin* by reducing income tax payable.

This study informs MNE groups seeking to headquarter in South Africa and the National Treasury of the effects of double taxation on South African-sourced services provided to other African countries and the requirement for relief against double taxation.

This study highlights the need for the National Treasury to retain section 6*quin* in the Income Tax Act or provide an alternate suitable solution to reducing double taxation on South African-sourced services provided by South African headquarter companies to other African countries.

Key Words: section 6*quin*, section 6*quat*, foreign tax credit, withholding tax, gateway into Africa, headquarter company, South African-sourced services, technical fees, management fees, administration fees, double taxation

DECLARATION

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

Ian Statham

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LIST OF ABBREVIATIONS

ATAF	African Tax Administration Forum
BEPS	Base erosion and profit shifting
CFC	Controlled foreign company
CUP	Comparable uncontrolled price method
DTA	Double Tax Agreement
EU	European Union
JSE	The Johannesburg Securities Exchange
MAP	Mutual Agreement Procedure
MNE	Multinational Enterprise
OECD	Organisation for Economic Co-Operation and Development
OECD MTC	OECD Model Tax Convention
OECD TP Guidelines	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
PwC	PricewaterhouseCoopers
SARS	South African Revenue Service

Chapter 1 – Introduction

1.1. Introduction to the section 6*quin* rebate supporting South Africa as the gateway into Africa

South Africa has a number of attributes which may encourage multinational enterprise (MNE) groups to incorporate intermediary companies in the country and to be headquartered in the country to provide services to African countries. An intermediary company typically acquires, manages, holds and/or sells investments in domestic and foreign companies.[1] A pure headquarter company does not own intangible assets, hold investments or carry on the main businesses of a MNE group: it provides auxiliary services on a centralised basis to a MNE group.[2]

For a number of years the South African government has promoted South Africa as the gateway into Africa. The South African Reserve Bank has relaxed exchange control regulations for general investment into Africa and for private equity investments into Africa. The Johannesburg Stock Exchange (JSE) has relaxed local listing rules in order for the JSE to position itself as a gateway for investment into Africa. According to Dianna Games, the CEO of research and consulting company, Africa at Work, South Africa has excellent banking institutions and has the best infrastructure in Africa. For many years South Africa has been a logistics and transport hub for Southern Africa and OR Tambo International Airport in Johannesburg is known as the best airport in Africa.[3]

The National Treasury has also implemented a number of initiatives in order to promote South Africa as a gateway into Africa and as a regional financial centre. The National Treasury introduced the headquarter company regime in 2010 and the domestic treasury management company regime in 2013 in order to encourage companies to manage their African and offshore operations from South Africa.[4]

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[1] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[2] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[3] Games, D. (2012). 'South Africa as Africa's Gateway: A Perspective from Business', *SAIIA Policy Briefing 46*
[4] South Africa. National Treasury. (2013). *Annexure W3 to the 2013 Budget Review: Gateway to Africa and other reforms.* Available from: http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W3.pdf (Accessed 23 May 2015).

Services typically provided by headquarter companies of MNE groups include accounting, audit, public relations, legal, computer, market research and marketing, and scientific support services, including treasury and tax management services.[5] Headquarter companies charge group companies management and administration fees for these services. Often these fees are charged to group companies in other jurisdictions.

In 2011, the National Treasury introduced a foreign tax rebate for South African-sourced service fees charged to other countries in the form of section 6*quin* of the Income Tax Act.[6] The Explanatory Memorandum[7] explained that withholding taxes on services (especially management services) are imposed by a number of African countries if funded by payments from their jurisdictions, irrespective of when tax treaties suggest otherwise and irrespective of whether the service is South African-sourced. Section 6*quin* was introduced to provide a foreign tax rebate on services rendered in South Africa to a foreign jurisdiction where tax was withheld by the foreign jurisdiction upon payment for the service. The introduction of section 6*quin* provided the South African taxpayer with relief from the double tax burden, including the administrative burden of trying to collect the withholding tax from the foreign jurisdiction. It is clear that the Treasury recognised that double taxation on services provided from South Africa to other African jurisdictions increased the cost of doing business with other African countries from South Africa.

In order for the South African taxpayer to claim the foreign tax rebate, the South African taxpayer is required to submit a declaration to the South African Revenue Service (SARS) within 60 days of the date on which the amount is withheld. SARS was to use this information to reduce or eliminate the foreign tax if that tax operated in violation of the tax treaty commitments.

[5] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[6] No. 58 of 1962.
[7] South Africa. National Treasury (2012). *Explanatory Memorandum on the Taxation Laws Amendment Bill 2011*. Available from: http://www.treasury.gov.za/legislation/acts/2011/EM%20for%20Taxation%20Laws%202011%20dated%2030%20Jan%202012.pdf (Accessed 23 August 2015).

In 2015, the National Treasury proposed that the section 6*quin* rebate be withdrawn. The Explanatory Memorandum[8] explained that the foreign tax rebate is a departure from international tax rules and tax treaty principles and indirectly subsidises countries that do not comply with the tax treaties. The Explanatory Memorandum[9] explained that some taxpayers exploited the relief by claiming a credit on other income such as royalties and interest which were not intended to be covered by the foreign tax rebate.

Compared to global standards, the withholding tax rates on services are generally high in Africa. The cost of double taxation, therefore, seems high when services are provided from South Africa into the rest of Africa. According to a Business Day report dated 15 April 2014, African governments are introducing higher withholding tax rates and withholding taxes on an increased range of services in an effort to protect their tax base from base erosion and profit shifting (BEPS).

In 2007, PricewaterhouseCoopers (PwC) conducted a survey titled 'Tax in Africa'. The survey was distributed to PwC tax clients in different industries and to PwC firms operating in the African region for completion. The survey concluded that the area of withholding tax posed the highest risk for the respondents as nearly 90% of the respondents considered withholding tax as either a high or medium risk.

In 2013, a similar survey was conducted by PwC. The 2013 survey highlighted that withholding taxes were still a major risk and were a high level of concern for 63% of the respondents. 87% of the respondents considered withholding tax as either a high or medium risk.

Withholding taxes appear to be problematic and costly when conducting business into Africa. It could be that if South Africa created a way to reduce the cost of providing

[8] South Africa. National Treasury (2015). *Draft Explanatory Memorandum on the Taxation Laws Amendment Bill 2015*. Available from: http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202015%20Draft/2015%20Draft%20Explanatory%20Memorandum%20for%202015%20draft%20TLAB%20-%2022%20July%202015.pdf (Accessed 23 August 2015).

[9] South Africa. National Treasury (2015). *Draft Explanatory Memorandum on the Taxation Laws Amendment Bill 2015*. Available from: http://www.treasury.gov.za/public%20comments/TLAB%20and%20TALAB%202015%20Draft/2015%20Draft%20Explanatory%20Memorandum%20for%202015%20draft%20TLAB%20-%2022%20July%202015.pdf (Accessed 23 August 2015).

services to African countries, South Africa would be more attractive as a hub for regional headquarters of MNE groups.

It is well known that the South African government has not done enough to encourage international investment into Africa and the possible withdrawal of section 6*quin* of the Income Tax Act[10] may be another reason for companies to seek alternate jurisdictions to set up headquarters where they can provide services to African countries. This is evident from the multinational mobile telecommunications company, MTN's warning to the South African Treasury on removing the section 6*quin* foreign tax rebate. One of the main considerations for MTN to locate its centralised service centre in South Africa was the provision of the section 6*quin* foreign tax rebate and if the rebate is withdrawn, the centralised service centre would run at a loss which would mean that MTN would consider relocating the centralised service centre out of South Africa.[11] The relocation of centralised service centres out of the country has multiple impacts, which include not only the loss of South African income from services provided to Africa but also the loss of hundreds of jobs.

[10] No. 58 of 1962.
[11] Ensor, L. (17 September 2015). 'MTN warns against removing African tax incentive', *Business Day*.

1.2. Research Problem

1.2.1. The statement of the problem

Most African jurisdictions impose withholding taxes on payments to non-residents for management, technical and consultancy services. Despite tax treaties providing relief, withholding taxes are still being withheld in some African jurisdictions. The result is that double taxation is often levied on the South African-sourced services with little relief.

This research study will analyse the problem of the increased cost of performing services from South Africa caused by withholding taxes within Africa, making it less attractive for MNE groups to headquarter in South Africa. This research study will also assess the impact of the relief provided by section 6*quin* compared to other double tax relief mechanisms available to the South African taxpayer.

A conclusion will be reached on the impact of double taxation and whether section 6*quin* provides more effective relief from double taxation compared to other double tax relief mechanisms available to the South African taxpayer which will incentivise MNE groups to headquarter in South Africa. Results will be presented on the income tax forfeited by SARS in the National Treasury providing this incentive to South African headquarter companies compared to if the headquarter is relocated out of South Africa.

1.2.2. The research questions

1.2.2.1. Research question 1

Are African countries withholding tax on services provided to them on a similar basis to international standards? This research study will compare tax withheld on services provided to African countries and European countries and will include the Organisation for Economic Co-operation and Development (OECD) commentary. The study will include an overview of withholding tax on services in the African countries and

European countries. A comparison will be drawn between the African and European country withholding tax on services and OECD commentary.

1.2.2.2. Research question 2

Does South Africa have sufficient and effective remedies to reduce double taxation on services being provided from South Africa to African countries? This research study will evaluate remedies available to South African taxpayers to reduce or eliminate double taxation on South African-sourced services provided to other African jurisdictions.

1.2.2.3. Research question 3

What is the cost to the fiscus due to the reduced income tax payable provided by section 6*quin* compared to income tax lost to the fiscus if a MNE group does not headquarter in South Africa? This research study will provide an assessment in the form of a case study of income tax forfeited by the fiscus in providing double taxation relief with the use of section 6*quin* and the income tax forfeited by the fiscus if a MNE group does not headquarter in South Africa.

Chapter 2 – Management and administration services into Africa from a South African headquarter company

2.1. Gateway into Africa

For a number of years the South African government has introduced reforms in order to support and encourage South African companies to expand into the rest of Africa and offshore. This can increase local tax revenue, dividends, competitiveness and jobs. If the country can strengthen their position as a Gateway into Africa, there will be economic growth and regional integration into the continent.[12]

From 2007 to 2011, 1 000 new investments into 36 African countries were established by South African companies. Of the total exports by South African companies in 2012, 17.6% were to African countries.[13]

If South Africa strengthens its position as a Gateway into Africa, South African companies will have opportunities to partner with international companies in developed economies to invest into Africa and/or export into Africa. South Africa, as a member of BRICS[14], could be a strong platform for investment into Africa.

In order to strengthen South Africa as the gateway into Africa, the South African Government has in 1997 reformed rules governing outward investment by local companies to facilitate direct investment into Africa. In 2004, reforms to encourage foreign companies to inward list in local capital markets were implemented which would support international companies investing into Africa. The limits on domestic capital funding offshore investment were also removed to facilitate international expansion. Other reforms included: the removal of formal South African Reserve Bank

[12] South Africa. National Treasury (2013). *Annexure W3 to the 2013 Budget Review: Gateway to Africa and other reforms.* Available from: http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W3.pdf (Accessed 23 May 2015).
[13] South Africa. National Treasury (2013). *Annexure W3 to the 2013 Budget Review: Gateway to Africa and other reforms.* Available from: http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W3.pdf (Accessed 23 May 2015).
[14] An association of five major emerging national economies: Brazil, Russia, India, China and South Africa.

approval processes for investments up to R500m; the allowance of South African institutional investors to hold an additional amount of African assets above foreign assets allowances; the allowance of South African banks to hold up to 25% of the value of liabilities in foreign assets; the mandate of certain private equity funds to invest in African without exchange control restrictions; the elimination of restrictions relating to tax and exchange control on investments which pass through South Africa into Africa with the use of a headquarter company regime; and the inclusion of a domestic treasury management company regime which has exchange control advantages and tax advantages with regards to foreign exchange transactions due to the allowance of the use of a functional currency other than South African Rands. All these reforms have been introduced to promote South Africa as the gateway into Africa.

South Africa has other strong attributes which contribute to being a gateway into Africa. The country has excellent banking institutions and has the best infrastructure in Africa. For many years South Africa has been a logistics and transport hub for Southern Africa and OR Tambo Airport in Johannesburg is known as the best airport in Africa[15].

South Africa has three areas which contribute to the country being a gateway into Africa. The areas are: South Africa's location, transport infrastructure, and a location for international companies to set up regional headquarters.[16]

There a number of African countries chasing the status of the gateway into Africa. Even in Southern Africa, Botswana and Mauritius offer low tax rates, expedited visa processes and attractive office rentals.[17] From a logistics and distribution perspective, Dubai, Nigeria, Mozambique, Angola and Kenya have also been considered to be gateways into Africa.[18]

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[15] Games, D. (2012). 'South Africa as Africa's Gateway: A Perspective from Business', *SAIIA Policy Briefing 46*.

[16] Draper, P. (2012). 'The Economic Gateway to Africa? Geography, Strategy and South Africa's Regional Economic Relations', *SAIIA Occasional Paper No 121*.

[17] Cohen, S.B. (1957). 'Geography and strategy: Their interrelationship', *Naval War College Review* (pp. 1–30).

[18] Spykman, N.J. (1938). 'Geography and foreign policy', *American Political Science Review* (pp. 28–50 & pp. 213–236; and Spykman, N.J. & Rollins, A.A. (1939). 'Geographic objectives in foreign policy I', *American Political Science Review* (pp. 391–410 & pp. 591–614).

2.2. South Africa as a location for headquarter companies of international groups

Headquarter companies are set up typically to provide services to a multinational group of companies which are auxiliary to the main business of the group. These services include accounting, audit, public relations, legal, computer, market research and marketing, and scientific support services, including treasury and tax management services.[19]

Countries which are attractive to international groups for setting up headquarter companies benefit from job creation as the services provided by the headquarter company are labour intensive.[20] Governments on a global basis seek to encourage multinational groups to set up headquarter companies in their jurisdiction. Headquarter companies tend to attract highly skilled individuals who provide professional services such as management consulting, auditing, and financial services. These highly skilled individuals are also high taxpayers in the countries where they provide their services. These individuals have an impact on the economies in which the headquarter companies are incorporated and potentially will invest in the communities in those headquarter company countries.[21]

Intermediary holding companies are used by multinational groups to acquire, manage, hold or sell investments in domestic or foreign companies.[22] Intermediary holding companies are incorporated between an ultimate holding company or shareholder and the group's operating subsidiaries. Intermediary holding companies are often set up in jurisdictions other than the jurisdiction of the ultimate holding company or shareholder.[23]

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[19] Spitz. (1999). *International Tax Havens Guide.* Juta; & Ogley. (1993). *Principles of International Tax: A Multinational Perspective.* Interfisc Publishers.
[20] Spitz. (1999). *International Tax Havens Guide*. Juta.
[21] Dr. Bloom, M & Grant, M. (2011). *Valuing Headquarters (HQs): Analysis of the Role, Value and Benefit of HQs in Global Value Chains.* Available from: http://www.international.gc.ca/economist-economiste/assets/pdfs/research/TPR_2011_GVC/10_Bloom_and_Grant_e_FINAL.pdf (Accessed 17 October 2015).
[22] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink
[23] Legwaila, T. (2012). *Tax characteristics of an ideal holding company location.* Available from: http://www.dejure.up.ac.za/index.php/en/volumes/45-vol-1-2012/64-article-2.html (Accessed 17 October 2015).

In 1997 the Katz Commission recognised that there were two advantages in encouraging international headquarter and intermediary holding companies to be incorporated in South Africa. The first advantage is that local companies will be encouraged to expand and to invest offshore. This will promote the retention of valuable human resources. The second advantage is that MNEs will be encouraged to invest and expand into Africa through South Africa. The benefit in these two factors is that South Africa will be able to recruit and maintain skills which will ultimately contribute to the economy.[24]

The Katz Commission[25] presented the following as the key fiscal attributes of a regime conducive to the formation of international holding companies:

> *'i. A reasonable double tax agreement (DTA) network;*
> *ii. The exemption of offshore corporate dividend income from local income tax;*
> *iii. The exemption of other defined offshore corporate income from local income tax;*
> *iv. The absence of local corporate capital gains tax;*
> *v. Low or no local withholding tax on dividends paid to shareholders; and*
> *vi. An efficient local tax rulings system.'*

The Katz Commission also presented the following as key fiscal attributes of a regime conducive to the formation of international headquarter and service companies:

> *'vii No tax on head office services rendered at the head office to the multi-national group; and*
> *viii. The exemption of offshore personal remuneration from local income tax, where the employee works exclusively offshore for a certain minimum period.'*

[24] Katz Commission. (1997). *Fifth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa*. (par 7.1.1)
[25] Katz Commission. (1997). *Fifth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa*. (par 7.1.4 & 7.1.5)

The National Treasury has implemented a number of initiatives to promote South Africa as a gateway to Africa and a regional financial centre. The National Treasury introduced the headquarter company regime in 2010 and the domestic treasury management company regime in 2013 to encourage companies to manage their African and offshore operations from South Africa.[26]

It is submitted that the headquarter company regime is more akin to a holding company regime as the provisions of the Income Tax Act relating to the regime facilitate the holding of equity shares in foreign companies, the provision of debt to foreign companies, and the provision of intellectual property to foreign companies. The headquarter company regime does, however, encourage foreign income in the form of rental, dividends, interest, royalty and *service fees.* The provision of services to foreign companies is indicative of a headquarter company regime.

The headquarter regime satisfies a number requirements of the key attributes of a regime conducive to the formation of international holding companies as described by the Katz Commission:

ii. The exemption of offshore corporate dividend income from local income tax.

    Dividends from foreign companies are exempt from South African Income Tax provided that at least 10% or more of the equity shares and voting rights are held by the South African headquarter company in the foreign company distributing the dividends.

iii. The exemption of other defined offshore corporate income from local income tax.

    South African headquarter companies are exempt from the South African Controlled Foreign Company ("CFC") rules. CFC rules require passive income

[26] South Africa. National Treasury (2013). *Annexure W3 to the 2013 Budget Review: Gateway to Africa and other reforms.* Available from: http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W3.pdf (Accessed 23 May 2015).

accrued in foreign companies to be included in the South African taxable income of shareholders where South African shareholders hold directly or indirectly more than 50% of the participating rights or voting rights in those foreign companies. South African shareholders of a South African headquarter company could be subject to CFC rules where South African shareholders hold directly or indirectly more than 50% of the participating rights or voting rights in a foreign company.

iv. The absence of local corporate capital gains tax.

The headquarter company must disregard any capital gains or capital losses on the disposal of the equity shares it holds in foreign companies provided that the headquarter held, directly or together with any other company forming part of the same group of companies[27] as the headquarter company, at least 10% of the equity shares and voting rights in the foreign company immediate before the disposal.

v. Low or no local withholding tax on dividends paid to shareholders.

Dividends distributed by a South African headquarter company to South African or foreign shareholders who hold at least 10% of the equity shares and voting rights in the headquarter company are exempt from South African income tax. Shareholders will also receive the exemption if they hold directly or together with any other company forming part of the same group of companies[28] as the shareholder company, at least 10% of the equity shares and voting rights in the headquarter company immediate.

The South African government has also initiated the following in accordance with the Katz Commission's key attributes of regimes conducive to the formation of international holding company and headquarter regimes:

[27] As defined in section 1 of the Income Tax Act
[28] As defined in section 1 of the Income Tax Act

i. A reasonable double tax agreement (DTA) network.

South Africa has steadily increased the number of double tax agreements it has with other countries to a reasonable number when compared to countries internationally. The South African government continues to increase and improve the double tax agreements it has with other countries.

iv. An efficient local tax rulings system.

In 2006 a scheme of Advance Tax Rulings was introduced. Prior to this, South Africa did not have a formal tax ruling system although taxpayers could approach SARS for guidance on the interpretation of the tax legislation. The rulings provided were divided into specific and general rulings. Specific rulings were not formal rulings and were not binding on either SARS or the taxpayer. From 2006, there were three types of rulings, namely, binding private rulings, binding general rulings, and non-binding rulings.[29] Advance Tax Rulings were refined further in the Tax Administration Act which came into effect in 2012.

vii. The exemption of offshore personal remuneration from local income tax, where the employee works exclusively offshore for a certain minimum period.

In 2002 the Income Tax Act included under section 10(1)(o) an income tax exemption on remuneration which accrues to an employee in respect of services rendered outside the Republic of South Africa for a period or periods exceeding 183 days during a 12-month period and for a continuous period exceeding 60 full days during that 12-month period. This is in line with international norms.

It is clear that the South African government has implemented what was seen by the Katz Commission to be key fiscal attributes of regimes conducive to the formation of international holding companies and headquarter companies. There is one key fiscal attribute of such regimes which has not been implemented. This is where it was

[29] Section 76 of the Income Tax Act & section 41A of the Value-Added Tax Act.

presented by the Katz Commission that there should be no tax on head office services rendered at the head office to the multi-national group.

Currently any services rendered within South Africa by a South African headquarter company to foreign subsidiary companies are taxed at the standard corporate tax rate of 28%. The South African government may avoid not taxing services rendered within South Africa by South African headquarter companies to their foreign subsidiaries for a number of reasons. These may include a loss of corporate income tax to the fiscus and also pressure internationally which is driven by the OECD in combating BEPS. OECD and European Union (EU) initiatives are driven by international co-operation to restrict practices where tax havens or even tax regimes of high tax countries are used to erode tax bases of other countries.[30]

2.3. Management and administration services into Africa

Typically a headquarter company will charge group companies a management and/or administration service fee for the services provided. As previously mentioned, these services include accounting, audit, public relations, legal, computer, market research and marketing, and scientific support services, including treasury and tax management services (cf. 2.2).

Although the services provided by a South African headquarter company could potentially create a permanent establishment in the other African country to which services are being provided, this research study does not address this aspect.

2.4. Conclusion

The Katz Commission recognised the benefit of MNE groups setting up headquarter companies in South Africa to provide management and administrative services into Africa. The Katz Commission defined a number of key attributes of a regime conducive to the formation of international headquarter and service companies. The South African government has implemented all of the key fiscal attributes of regimes

[30] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

conducive to the formation of headquarter companies to some degree, except one. Where the Katz Commission provided that there should be no tax on head office services rendered at the head office to the multi-national group, services provided by a South African headquarter company to foreign connected persons are taxed at the standard corporate tax rate of 28%.

Chapter 3 – Transfer pricing on management and administration services into Africa

3.1. Introduction

Services provided by a South African headquarter company to other African countries will be subject to transfer pricing legislation in South Africa and, potentially, in the other African country.

3.2. The OECD Transfer Pricing Guidelines

Arnold & McIntyre *International Tax Printer* (2002) 55 defined transfer pricing as:

> *'A transfer price is a price set by a taxpayer when selling to, buying from, or sharing resources with a related person. For example, if ACo manufactures goods in country A and sells them to its foreign affiliate, BCo, organised in country B, the price at which that sale takes place is called a transfer price. A transfer price is usually contrasted with a market price, which is the price set in the market place for transfers of goods and services between unrelated persons'*

Without transfer pricing legislation, MNE groups could shift profits to low tax jurisdictions by manipulating prices of goods and services sold or provided to group companies. By doing this, MNE groups could reduce their effective tax rate substantially.[31] Cross border transactions have increased on a global basis in recent years and accordingly most tax authorities have implemented transfer pricing provisions in their domestic tax legislation which typically entails the tax authorities having the authority to adjust the transfer prices set by the multinational groups of companies.[32]

[31] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[32] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines) has been adopted to a greater or lesser extent by most countries. The OECD TP Guidelines are evident in the OECD Model Tax Convention (OECD MTC) and also in countries' domestic legislation and guides where the OECD TP Guidelines are often referred to. South Africa has also adopted the OECD TP Guidelines in order to establish arm's length principles.[33]

Market forces determine the price of services provided between independent companies. When associated companies transact with each other, external market forces may not determine the price of services between the companies. Associated companies should seek to replicate the dynamics of market forces in order to achieve a transaction performed at arm's length.[34]

The OECD TP Guidelines highlight two issues in the analysis of transfer pricing on service transactions between MNE group companies: the first issue is whether a service has actually been provided; the second issue is at what price the service transaction should be provided for the transaction to be at arm's length.

The first issue is addressed by assessing if the recipient company of the service has received economic or commercial value and if the recipient company would be willing to pay for the service provided if the provider of the service were an independent company. The second issue is addressed by assessing if the price charged for the service provided between MNE group companies is comparable to a price that would be charged between two independent companies.[35]

The OECD TP Guidelines encourage MNEs to use the direct-charge method when charging for services between MNE group companies. The direct-charge method entails charging on specific intra-group services on a clearly identified basis. The direct-charge method can be difficult to apply in practice and so MNE groups have been required to seek alternate methods for charging for services. In the case of a

[33] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[34] OECD. (2010). *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. OECD Publishing.
[35] OECD. (2010). *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. OECD Publishing.

headquarter company providing services such as accounting, audit, public relations, legal, computer, market research and marketing, and scientific support services, including treasury and tax management services to a number of associated companies, the direct-charge method may not be appropriate. MNE groups often choose cost allocation and apportionment methods. These methods are generally referred to as indirect-charge methods. It is important that the result of the price charged for the service is consistent with a price that would be charged between two companies transacting at arm's length.

3.3. Calculating the arm's length consideration – OECD

When calculating the arm's length price to be charged between associated companies, consideration is required from both the service provider's perspective and the service recipient's perspective. Consideration is required on the value of the service provided and the cost to the service provider and what the recipient of the service would be willing to pay if the service were provided by an independent company. Chapters I, II, and III of the OECD TP Guidelines provide methods to determine an arm's length price for services between associated companies. The outcome of these chapters suggest that a comparable uncontrolled price method (CUP) or a cost-plus method be utilised. The CUP method entails comparing the service controlled transaction between the associated companies to a comparable uncontrolled transaction in comparable circumstances. The CUP method is appropriate where there are comparable services provided between independent companies. It may be possible to compare controlled service transactions such as accounting, auditing, legal, and computer services to uncontrolled service transactions.

Where the CUP method is not appropriate, the cost-plus method can be used. The cost-plus method requires an estimation of a mark-up on costs to the service provider, taking into consideration the functions performed, assets used and risks assumed and comparing those to independent companies.

Transactional profit methods such as the transactional net margin method and the transactional profit split method may be used where most appropriate. This may the case when the CUP method and cost-plus method are difficult to apply. Transactional profit methods entail examining profits arising from particular controlled service transactions. The conditions affecting profits arising from the controlled service transactions are compared to conditions affecting profits arising from service transactions between independent companies in order to establish arm's length pricing.

Where it may be difficult to apply a single method, it may be helpful to apply more than one method in establishing a reasonable transfer price for services provided.

A functional analysis of the South African headquarter company and the associated company is helpful to establish the role and contributions of the entities involved and the services provided. A functional analysis assists with the establishment of a reasonable transfer price for services provided.

3.4. Transfer pricing – South African legislation

Section 31 of the Income Tax Act incorporates transfer pricing principles. From 1 October 2011, an amended section 31 was effective which reads as follows:

'(2) Where-

(a) any transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both—

(i) (aa) a person that is a resident; and

(bb) any other person that is not a resident;

(ii) (aa) a person that is not a resident; and

(bb) any other person that is not a resident that has a permanent establishment in the Republic to which the transaction, operation, scheme, agreement or understanding relates;

(iii) (aa) a person that is a resident; and

(bb) any other person that is a resident that has a permanent establishment outside the Republic to which the transaction, operation, scheme, agreement or understanding relates; or

(iv) (aa) a person that is not a resident; and

(bb) any other person that is a controlled foreign company in relation to any resident,

and those persons are connected persons in relation to one another; and

(b) any term or condition of that transaction, operation, scheme, agreement or understanding-

(i) is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length; and

(ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,

the taxable income or tax payable by any person contemplated in paragraph (b)(ii) that derives a tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length.' [emphasis added]

From the above, it is clear that Section 31 requires that the terms and conditions of cross-border transactions between connected persons must be comparable to the terms and conditions of those transactions had those persons been independent persons dealing at arm's length.

Section 31 provides that where the terms and conditions of cross-border transactions between connected persons are not comparable to the terms and conditions of those transactions had those persons been independent persons dealing at arm's length, the taxable income or tax payable by a person party to that transaction must be calculated as if that transaction had been entered into by independent persons dealing at arm's length.

The wording in section 31 follows the wording contained in the OECD MTC and OECD TP Guidelines.[36] Article 9 of the OECD MTC deals with transactions between

[36] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

associated enterprises and with profits which require adjustment for tax purposes due to transactions entered into not being at arm's length.

The OECD TP Guidelines provide the authoritative statement of the arm's length principle and adjustment to taxable income or tax payable:

'B1 Article 9 of the OECD Model Tax Convention

> *1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. Article 9 provides:*
>
> > *[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.'*

Where South African headquarter companies provide services to other MNE group companies in other African countries, it is important that the services provided are charged at an arm's length price. If the services are not charged at an arm's length price there is a risk that companies party to the transaction will incur additional taxes, penalties, and/or interest.

It must be noted that section 31 does not apply to any loan advanced to a headquarter company as defined in section 9I of the Income Tax Act and also does not apply to any loan the headquarter company advances to a company in which it holds directly or indirectly at least 10% of the equity shares and the voting rights. This is one incentive provided by the National Treasury to encourage MNE groups to headquarter in South Africa.

3.5. Conclusion

Section 31 and the OECD TP Guidelines provide that any services provided by a South African headquarter company to an associated company in Africa, the terms and conditions of that transaction must be comparable to the terms and conditions of the transaction had the parties to the transaction been independent persons dealing at arm's length.

The OECD TP Guidelines provide guidance on transfer pricing methodologies which can be used by MNE groups on intra-group transactions.

Section 31 and the OECD MTC provide for an adjustment of taxable income or tax payable if the price of the service is not at arm's length. This raises a risk that companies party to the transaction will incur additional taxes, penalties, and/or interest.

Chapter 4 – An analysis of withholding taxes within Africa

4.1. Introduction

The OECD has been integral in addressing BEPS. As cited by Amanda Visser in the Business Day, the executive secretary of the African Tax Administration Forum (ATAF), Logan Wort says that, although the issue of withholding taxes is not on the OECD's agenda for addressing base erosion, it certainly is on ATAF's [agenda]. The ATAF views the implementation of withholding taxes as a solution to protecting the tax bases of African countries.

Although a state may have the right to tax income of a non-resident, the collection of that tax is sometimes problematic. An effective method of collecting the tax payable by a non-resident is to apply a withholding tax on the payment to the non-resident. Withholding tax is almost always levied on the gross amount of the transaction and the non-resident cannot claim any deductions in the source state. In some jurisdictions it is possible for a non-resident to register for tax in that jurisdiction and claim the expenditure incurred as a tax deduction against the production of income on which the tax was withheld.[37]

The procedure for collecting taxes under a withholding tax mechanism is that the resident of a state becomes the agent of the non-resident. When a payment is made by the resident to the non-resident, the resident is obliged to withhold tax calculated as a percentage of the payment to the non-resident. The withholding tax is paid over to the tax authorities of the resident's state. If a resident does not withhold tax on the payment to the non-resident, the resident typically incurs penalties.[38]

[37] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[38] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

4.2. Withholding taxes on services according to the OECD

Internationally, countries have adopted either a source jurisdiction (territoriality jurisdiction) or residence jurisdiction basis of taxation. Countries which have adopted residence jurisdiction typically tax non-residents on source basis.[39]

The OECD defines withholding tax as:

> *'Tax on income imposed at source, i.e. a third party is charged with the task of deducting the tax from certain kinds of payments and remitting that amount to the government. Withholding taxes are found in practically all tax systems and are widely used in respect of dividends, interest, royalties and similar tax payments. The rates of withholding tax are frequently reduced by tax treaties.'*[40]

The OECD defines source of income as:

> *'The place (or country) where a particular item of income is deemed to originate or where it is deemed to be generated. National rules vary, depending on which concept of source is used.'*[41]

The OECD defines source rule as:

> *'Provision in the national law of a country or in a tax treaty which defined the concept of source for a particular type of income.'*[42]

Countries have different concepts of source. The source of services rendered could be the place where the services are performed or the place where payment is made.[43]

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[39] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.
[40] OECD (n.d.). *Glossary of Tax Terms.* Available from: http://www.oecd.org/ctp/glossaryoftaxterms.htm#W (Accessed 12 December 2015).
[41] OECD (n.d.). *Glossary of Tax Terms.* Available from: http://www.oecd.org/ctp/glossaryoftaxterms.htm#W (Accessed 12 December 2015).
[42] OECD (n.d.). *Glossary of Tax Terms.* Available from: http://www.oecd.org/ctp/glossaryoftaxterms.htm#W (Accessed 12 December 2015).
[43] Rohatgi, R. (2005). *Basic International Taxation.* Richmond: Richmond Law & Tax Ltd.

Although there is a view that internationally the source of services rendered could be the place where the services are performed or the place where payment is made, it would appear that the OECD understands that usually a non-resident will not be taxed by a country where the payer resides on services provided by the non-resident unless the non-resident provided that service through a permanent establishment situated therein. This can be seen in the commentary from the OECD Transfer Pricing Guidelines:

> *'…whether or not a withholding tax is levied on payments made to non-residents may depend on the way the contract is viewed. If the payment is seen as service fees, it is usually not taxed in the country of origin unless the receiving enterprise carries on business in that country through a permanent establishment situated therein and the fee is attributable to the permanent establishment.'*[44]

It appears that the OECD's view of source is that internationally the source of income is usually where the services are performed. This is consistent with DTAs, for example, between South Africa and Botswana, where in Article 20 paragraph 5 relating to technical fees, the DTA provides that technical fees shall be *deemed* to arise in a Contracting State when the payer is a resident of that State. The word 'deemed' indicates that the actual source can be in the other State.

[44] OECD (2010). *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. OECD Publishing.

4.3. An analysis of withholding taxes on services in European countries

The table below provides withholding taxes on services in European countries. Services typically include management, technical and consultancy services.

Withholding Taxes on Services in European Countries

	Country	Withholding Tax on Services Source: Where Payer Resides	Withholding Tax on Services Source: Where Service Performed	Withholding Tax on Payments to Tax Havens or Low Tax Jurisdictions	Notes
1	Albania	15%	-	-	
2	Andorra	-	10%	-	
3	Armenia	-	20%	-	
4	Austria	20%	-	-	
5	Azerbaijan	-	10%	-	
6	Belarus	15%	-	-	
7	Belgium	-	-	16.50%	
8	Bosnia and Herzegovina	-	10%	-	
9	Bulgaria	10%	-	-	
10	Croatia	15%	-	20%	
11	Cyprus	-	10%	-	
12	Czech Republic	-	15%/35%	35%	
13	Denmark	-	-	-	
14	Estonia	-	10%	20%	
15	Finland	-	-	-	
16	France	-	33.30%	75%	
17	Georgia	-	10%	-	
18	Germany	-	-	-	
19	Greece	-	20%	-	
20	Hungary	-	-	-	
21	Iceland	20%	-	-	
22	Ireland	-	-	-	
23	Italy	-	-	-	
24	Kazakhstan	-	-	20%	
25	Kosovo	-	Note 1	-	
26	Latvia	Note 2	-	15%	
27	Liechtenstein	-	-	-	
28	Lithuania	-	-	-	
29	Luxembourg	-	-	-	
30	Macedonia	-	-	-	Note 3
31	Malta	-	-	-	
32	Moldova	12%	-	-	
33	Monaco	-	-	-	
34	Montenegro	-	9%	-	
35	Netherlands	-	-	-	

Withholding Taxes on Services in European Countries (continued)

	Country	Withholding Tax on Services Source: Where Payer Resides	Withholding Tax on Services Source: Where Service Performed	Withholding Tax on Payments to Tax Havens or Low Tax Jurisdictions	Notes
36	Norway	-	-	-	
37	Poland	20%	-	-	
38	Portugal	25%	-	-	
39	Romania	-	16%	-	
40	Russia	-	-	-	
41	San Marino	-	-	-	
42	Serbia	-	-	25%	
43	Slovakia	-	19%/35%	-	
44	Slovenia	-	-	15%	
45	Spain	-	24%/20%	-	
46	Sweden	-	-	-	
47	Switzerland	-	-	-	
48	Turkey	-	20%	30%	
49	Ukraine	-	-	-	Note 4
50	United Kingdom	-	-	-	

Note 1: 5% if compensation exceeds EUR5000 in tax period
Note 2: 0% on technical & 10% on management and consulting fees
Note 3: Telecommunication service fees paid to a nonresident are subject to a 10% withholding tax, unless the rate is reduced under a tax treaty.
Note 4: 0% on technical & 20% on advertising outside country & 15% on engineering.

Table 1: Withholding taxes on services in European countries[45]

Out of the 50 European countries (excluding the Vatican City), 10 countries levy a withholding tax on payments to non-residents for services, irrespective of where the service was provided. This includes Latvia which levies a withholding tax on management and consulting fees but not on technical fees. Croatia increases the withholding tax levied where a payment is made to a non-resident who resides in a tax haven or low tax jurisdiction.

[45] Sources: PricewaterhouseCoopers (2015). *Worldwide Tax Summaries Online.* Available from: http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/tax-summaries-home (Accessed 6 September 2015 – 6 December 2015); Deloitte & Touche (2015). *Tax guides and highlights.* Available from: https://dits.deloitte.com/#TaxGuides (Accessed 6 September 2015 – 6 December 2015); Angloinfo (2015). *General Taxes in Monaco.* Available from: http://monaco.angloinfo.com/information/money/general-taxes/ (Accessed 29 November 2015); World Bank Group (2015). *Paying Taxes in San Marino.* Available from: http://www.doingbusiness.org/data/exploreeconomies/san-marino/paying-taxes/ (Accessed 29 November 2015).

16 countries levy a withholding tax on services paid to non-residents where the service was rendered in the country of the payer. Four of those countries increase the withholding tax levied where a payment is made to a non-resident who resides in a tax haven or low tax jurisdiction.

20 countries do not levy a withholding tax on services provided by a non-resident which would be considered typically to be services provided by a headquarter company. Macedonia levies withholding tax on telecommunication service fees paid to a non-resident and the Ukraine levies withholding tax on engineering services and advertising fees paid to a non-resident.

Four countries levy a withholding tax on payments to non-residents for services only where the non-resident resides in a tax haven or low tax jurisdiction.

4.4. An analysis of withholding taxes on services in African countries

The table below provides withholding taxes on services in African countries. Services typically include management, technical and consultancy services.

Withholding Taxes on Services in African Countries

	Country	Withholding Tax on Services Source: Where Payer Resides	Withholding Tax on Services Source: Where Service Performed	Withholding Tax on Payments to Tax Havens or Low Tax Jurisdictions	Notes
1	Algeria	24%	-	-	
2	Angola	6.50%	-	-	
3	Benin	12%	-	-	
4	Botswana	15%	-	-	
5	Burkina Faso	20%	-	-	
6	Burundi	15%	-	-	
7	Cameron	15%	-	-	
8	Cape Verde	-	-	-	
9	Central African Republic	15%	-	-	
10	Chad	25%	-	-	
11	Comoros	10%	-	-	
12	Democratic Republic of the Congo	14%	-	-	
13	Republic of the Congo	20%	-	-	
14	Djibouti	10%	-	-	
15	Egypt	20%	-	-	
16	Equatorial Guinea	10%	-	-	
17	Eritrea	10%	-	-	
18	Ethiopia	10%	-	-	
19	Gabon	10%	-	-	
20	Gambia	15%	-	-	
21	Ghana	20%	-	-	
22	Guinea	-	-	-	
23	Guinea-Bissau	Unknown	-	-	
24	Ivory Coast	20%	-	-	
25	Kenya	20%	-	-	
26	Lesotho	10%	-	-	
27	Liberia	15%	-	-	
28	Libya	-	-	-	
29	Madagascar	10%	-	-	
30	Malawi	15%	-	-	
31	Mali	17.50%	-	-	
32	Mauritania	15%	-	-	
33	Mauritius	-	10%	-	Note 1
34	Morocco	10%	-	-	
35	Mozambique	20%	-	-	

Withholding Taxes on Services in African Countries (continued)

Country	Withholding Tax on Services Source: Where Payer Resides	Withholding Tax on Services Source: Where Service Performed	Withholding Tax on Payments to Tax Havens or Low Tax Jurisdictions	Notes
36 Namibia	25%	-	-	
37 Niger	16%	-	-	
38 Nigeria	10%	-	-	
39 Rwanda	15%	-	-	
40 São Tomé and Príncipe	20%	-	-	
41 Senegal	20%	-	-	
42 Seychelles	15%	-	-	
43 Sierra Leone	10%	-	-	
44 Somalia	Unknown	-	-	
45 South Sudan	-	-	-	
46 Sudan	15%	-	-	
47 Swaziland	15%	-	-	
48 Tanzania	15%	-	-	
49 Togo	15%	-	-	
50 Tunisia	15%	-	-	
51 Uganda	15%	-	-	
52 Zambia	20%	-	-	
53 Zimbabwe	15%	-	-	

Note 1: A 3% withholding tax is levied on payments to providers of services such as an architect, attorney/solicitors, barrister, dentist, doctor, engineer, land surveyor, legal consultant, project manager in the construction industry, quantity surveyor, and property valuer.

Table 2: Withholding taxes on services in African countries[46]

Out of the 53 African countries (excluding South Africa), 46 countries levy a withholding tax on payments to non-residents for services irrespective of where the service was provided.

[46] Sources: Deloitte & Touche (2015). *Guide to Fiscal Information. Key Economies in Africa 2014/2015.* Johannesburg: Creative Solutions at Deloitte; PricewaterhouseCoopers (2015). *Worldwide Tax Summaries Online.* Available from: http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/tax-summaries-home (Accessed 6 September 2015 – 6 December 2015); Deloitte & Touche (2015). *Tax guides and highlights.* Available from: https://dits.deloitte.com/#TaxGuides (Accessed 6 September 2015 – 6 December 2015); BMCE Bank of Africa (2015). *Djibouti : Investir.* Available from: http://www.bmcetrade.com/fr/observer-les-pays/djibouti/investir-3?forcer_langue=en& (Accessed: 29 November 2015); KPMG (2014). *Liberia Fiscal Guide 2014/15.* Available from: https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2014-15%20Fiscal%20Guides/LIBERIA-Fiscal%20Guide-2014.pdf (Accessed 29 November 2015); Ernst & Young (2014). *Worldwide Corporate Tax Guide 2014.* Available from: http://www.ey.com/Publication/vwLUAssets/Worldwide_corporate_tax_guide_2014/$FILE/Worldwide%20Corporate%20Tax%20Guide%202014.pdf (Accessed 31 October 2015); Contractor Taxation (2015). *Withholding Tax Tables (Global).* Available from: http://contractortaxation.com/withholding-tax-tables (Accessed 31 October 2015).

Only Mauritius levies a withholding tax on services paid to non-residents where the service was rendered in the country of the payer.

Five African countries do not levy a withholding tax on services provided by a non-resident which would be considered typically to be services provided by a headquarter company.

Information on withholding tax on services was not available for Guinea-Bissau and Somalia.

4.5. Conclusion

When analysing withholding tax on services such as management, technical and consultancy services which typically a headquarter company would provide, most of the African countries levy a withholding tax on payments to non-residents for services, irrespective of where the service is provided. When comparing this to countries in Europe, most European countries either do not levy withholding tax on services provided by non-residents or levy a withholding tax on services paid to non-residents where the service is rendered in the country of the payer.

It appears that the OECD's view of source is that, internationally, the source of income is usually where the services are performed. Based on this, South African-sourced services provided by a South African headquarter company should not be taxed by the country where the payer resides. It is clear that African countries do not follow this approach and where services are provided to an African country by a non-resident, even when those services are not provided through a permanent establishment situated in that African country, there typically will be a withholding tax levied on the gross payment amount for that service, irrespective of where the actual source is of the service provided. Without double tax relief, the withholding tax levied in the African countries on these services increases the cost of providing services to the African countries from South Africa.

Chapter 5 – An analysis of relief provided against double taxation on services from South Africa into Africa

5.1. Introduction

Companies which are tax resident in South Africa are subject to income tax on their worldwide taxable income, irrespective of the source of the income. A headquarter company incorporated and tax resident in South Africa will be subject to income tax on the services it provides to other companies in a MNE group.

Services provided by a South African headquarter company to other countries may be subject to withholding tax in the country of the payer of the service. Some countries withhold tax on services only if the source of the service is in the country of the payer. Other countries withhold tax on services, irrespective of where the actual source of the service is. It can be seen in section 4.4 above that most African countries levy withholding tax on services irrespective of where the actual source is. Countries withhold tax on different categories of services such as technical fees, business consultancy fees, management fees, administration fees and other categories of services.[47]

Where services are provided in South Africa by a South African company to a company in another country where that country levies a withholding tax on services, irrespective of where the actual source is of that service, the South African company will be exposed to double taxation. It is submitted that most countries levy a withholding tax on the gross service fee. This means that the South African company providing the service into Africa is not only exposed to double taxation but is also potentially exposed to excessive taxation.

This chapter analyses the relief provided against double taxation on such services. As cited by Olivier and Honiball (2011), the IBFD International Tax Glossary (2001) 352 defines double taxation relief as the generic term for all methods used to reduce or

[47] International Fiscal Association (2014). *Cahiers de Droit Fiscal International, Volume 99a, Cross-border outsourcing – issues, strategies and solutions.* Sdu Uitgevers.

defer the burden of taxation without regard to the manner in which this is accomplished. Relief from double taxation in South Africa is obtained bilaterally with the utilisation of double taxation treaties and unilaterally with the use of domestic legislation.

5.2. Double taxation agreements

A DTA is an agreement between two countries in terms of which the countries agree to mitigate the effects of double taxation and in which country income or capital must or may be taxed. DTAs override the provisions of domestic legislation.[48]

5.2.1. Article 7

Many of the comprehensive DTAs between South Africa and other African countries are based on the OECD Model Tax Treaty.[49] Article 7 of the OECD Model Tax Convention allocates taxing rights to the country in which a company is tax resident with respect to business profits of that company, provided that the profits are not subject to another Article of the Convention. If that company carries on business in the other country through a permanent establishment, the profits attributable to that permanent establishment may be taxed in the other country.[50]

Assuming that a South African company has not created a permanent establishment in an African country, if a South African company is providing services from South Africa to that African country where a DTA exists between the two countries and there is no Article in the DTA other than Article 7 which covers the services being provided, the profits on those services will be taxed in South Africa.

[48] OECD (2010). *OECD Model Tax Convention on Income and on Capital (Condensed version 2010)*. Paris: OECD Publications.
[49] Koekemoer et al. (2015). *Silke: South African Income Tax* (Stiglingh, M. Ed.) Durban: LexisNexis.
[50] OECD (2010). *OECD Model Tax Convention on Income and on Capital (Condensed version 2010)*. Paris: OECD Publications.

5.2.2. Articles relating to technical fees or management fees

5.2.2.1. DTAs which include specific articles related to technical fees or management fees

There are currently 22 comprehensive DTAs in place between South Africa and other African countries. Of those 22, four specifically include an Article which addresses technical fees or management fees. The DTA between South Africa and Ghana is the only DTA which includes an Article headed 'Management Fees'. Management fees in that DTA are defined as follows:

'Management Fees

3. *The term "management fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a managerial, technical or consultancy nature. Provided that the term "management fees" shall not include any payments in consideration for supervisory activities in connection with a building site or construction, assembly or installation project or for supervisory activities in connection with installation incidental to the sale of machinery or parts thereof.'*

DTAs between South Africa and Botswana, Tunisia, and Uganda include an Article headed 'Technical Fees'. Technical fees in those DTAs are defined as follows:

'Technical Fees

3. *The term "technical fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any service of an administrative, technical, managerial or consultancy nature.'*

It would appear from the above definitions of management fees and technical fees that the two address substantially the same types of services, which are typically services provided by headquarter companies (cf. 2.3).

5.2.2.2. *Example of DTA addressing technical fees*

The DTA between South Africa and Botswana includes an Article 20 which covers Technical Fees. The Article states the following:

'Article 20

Technical Fees

1. *Technical fees arising in a Contracting State which are derived by a resident of the other Contracting State may be taxed in that other State.*

2. *However, such technical fees may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but where such technical fees are derived by a resident of the other Contracting State who is subject to tax in that State in respect thereof, the tax charged in the Contracting State in which the technical fees arise shall not exceed 10 per cent of the gross amount of such fees.*

   The competent authorities of the Contracting States shall settle the mode of application of this limitation by mutual agreement.

3. *The term "technical fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of an administrative, technical, managerial or consultancy nature.*

4. *The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the technical fees, being a resident of a Contracting State, carries on business in the other Contracting State in which the technical fees arise, through a permanent establishment situated therein and the technical fees are effectively connected with such permanent establishment. In such a case, the provisions of Article 7 shall apply.*

5. *Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the technical fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the technical fees was incurred, and such technical fees are borne by that permanent establishment, then such technical fees shall be deemed to arise in the State in which the permanent establishment is situated.*

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

Paragraph 5 of Article 20 of the DTA between South Africa and Botswana provides that technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State. If South African-sourced services are provided from South Africa to Botswana, the services are deemed to arise in Botswana if payment is made from Botswana. It is clear that the actual source of the service is irrelevant. It is also irrelevant whether the service is provided in South Africa by a South African company to a Botswana company, or provided in Botswana by a South African company to a Botswana company, or provided in Botswana by a South African company through a permanent establishment in Botswana to a company in Botswana. The Article does, however, limit the tax charged in Botswana to 10 per cent of the gross amount of such fees.

The following table presents what the standard withholding tax rate on services is reduced to where DTAs between South Africa and other African countries include an article addressing technical fees or management fees:

	Standard Withholding Tax on Technical / Management Fees	DTA Reduced Rate
Botswana	15%	10%
Ghana	20%	10%
Tunisia	15%	12%
Uganda	15%	10%

Table 3: Withholding tax rates on services provided by South Africa to Botswana, Ghana, Tunisia & Uganda

5.2.3. DTAs between South Africa and African countries where management fees are specifically excluded

DTAs between South Africa and the other African countries of Malawi, Sierra Leone, Zambia and Zimbabwe do not address double taxation cases related to management charges and so any tax withheld by the foreign tax authority on service fees included in the term "management charges" paid to a South African tax resident will not be reduced in accordance with the DTAs currently in force.

5.3. Foreign tax credits

5.3.1. The OECD Model Tax Convention

Articles 23 A and 23 B of the OECD MTC prescribe methods for the elimination of double taxation where so-called juridical double taxation occurs when income or capital is taxable by two jurisdictions in the hands of a single taxpayer. The OECD MTC provides three cases where juridical double taxation may arise. Only one case closely relates to the scenario where a South African headquarter company provides services to another African country and the services are not provided through a permanent establishment in the other African country. This case is:

> *'…where a person is a resident of a Contracting State (R)[51] and derives income from… the other Contracting State (S)[52] and both States impose tax on that income.'* [emphasis added]

5.3.1.1. Source

It appears that the OECD's view of source is that, internationally, the source of income usually would be where the services are performed (cf. 4.2).

DTAs, for example, between South Africa and Botswana where in paragraph 5 of Article 20 relating to technical fees, the DTA provides that technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that state. If the South African-sourced service provided by a South African headquarter company to another African country is deemed to be sourced in the other African country in accordance with a DTA between South Africa and the other African country, then both countries are required to treat the source of the service in the country where the payer is resident. In this case, the source is deemed to be in Botswana.

The above scenario is consistent with the juridical double taxation case where a person is a resident of a Contracting State (R) and derives income from the other Contracting State (S) and both states impose tax on that income.

[51] "R" stands for the state of residence within the meaning of the OECD Model Tax Convention.
[52] "S" stands for the state of source or situs.

5.3.1.2. Article 23 A – exemption method

Article 23 A of the OECD MTC provides for an exemption from tax in the state of residence where income is taxed by the other state.

> Example:
>
> A South African headquarter company provides South African-sourced service fees to another African country. A DTA between South Africa and the other African country deems the source of the service fees to be in the country where the payer is resident. As a result, the source of the service fees will be the other African country. The other African country levies a tax which is withheld on the payment to the South African headquarter company for the services provided.

An Article in a DTA between South Africa and another African country which is in accordance with Article 23 A of the OECD MTC would typically require South Africa to exempt the service income (gross less allowable expenses) from South African normal taxation for the South African headquarter company.

There are four DTAs between South Africa and other African countries where the source of technical or management fees are deemed to be in the country where the payer is resident. Those DTAs are with Botswana, Ghana, Tunisia and Uganda. None of these DTAs provides for an exemption in accordance with Article 23 A of the OECD MTC.

5.3.1.3. Article 23 B – credit method

Article 23 B of the OECD MTC provides for a credit against tax in the state of residence where income is taxed by the other State.

Using the example presented above under section 0, an Article in a DTA between South Africa and another African country which is in accordance with Article 23 B of the OECD MTC would typically require South Africa to provide either a full credit or ordinary credit against South African normal taxation for the South African headquarter company.

The full credit method provides a credit against taxation of a resident company to the extent of the tax paid in the other country. None of the South African DTAs provides for a full credit method.[53]

The ordinary credit method provides a credit against taxation of a resident company to the extent of taxation in the resident country related to income which has been taxed in the other country.[54]

The DTAs of Botswana, Ghana, Tunisia and Uganda provide a deemed source provision on technical or management fees where the source of technical or management fees is deemed to be in the country where the payer is resident, even though the actual source of services provided by the South African headquarter company, in the example above, is in South Africa. Botswana, Ghana, Tunisia and Uganda can thus levy a withholding tax on the technical or management fees paid to the South African headquarter company, subject to certain percentage limitations.

All four of the DTAs above include an Article which is consistent with Article 23 B of the OECD MTC. The South African headquarter company can seek relief from double taxation in accordance with this.

5.3.1.1.1. Double tax agreements with Botswana, Ghana and Uganda

The DTAs between South Africa and Botswana, Ghana and Uganda include an Article which is consistent with Article 23 B of the OECD MTC. The relevant Articles are worded in a similar fashion to each other and provide:

> *'In South Africa, subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country*

[53] OECD (2010). *OECD Model Tax Convention on Income and on Capital (Condensed version 2010)*. Paris: OECD Publications.
[54] OECD (2010). *OECD Model Tax Convention on Income and on Capital (Condensed version 2010)*. Paris: OECD Publications.

other than South Africa, [the other African country] tax paid by residents of South Africa in respect of income taxable in [the other African country], in accordance with the provisions of this Convention, shall be deducted from the taxes due according to South African fiscal law. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income.' [emphasis added]

The Article provides that the South African headquarter company can obtain a tax credit against South African normal taxation for the tax paid in the other country on income that is also taxed in South Africa.

The Article provides that the credit is *subject to* the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa.

As the credit is subject to the provisions of the law of South Africa, in applying the DTA, the South African headquarter company will be required to apply section 6*quat* of the South African Income Tax Act in order to determine the credit.

The Article also provides that:

> *'Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income.'*

If the South African headquarter company elects to use the DTA for the credit, the headquarter company will be required to use section 6*quat* for the credit relief and then be further limited by a per country limitation calculation as required by the DTA. It is submitted that the headquarter company would not elect to use the DTA for the credit and would apply only section 6*quat* for the credit relief.

5.3.1.3.2. Double tax agreement with Tunisia

The DTA between South Africa and Tunisia includes an Article which is consistent with Article 23 B of the OECD MTC. The relevant Article provides:

> *'Where a resident of a Contracting State derives income which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident, an amount equal to the tax paid in that other Contracting State. Such deduction shall not, however, exceed an amount which bears to the total tax payable in the first-mentioned State the same ratio as the income concerned bears to the total income.'*

The South African headquarter company can elect to use the DTA for the credit and to determine the credit in accordance with the DTA. The South African headquarter company has a choice to use the DTA or section 6*quat* to determine the credit. It is not entitled to determine the credit in accordance with the DTA and section 6*quat*. Section 6*quat* or the DTA can be exercised annually and does not need to be consistent with previous years of assessment. Where a number of DTAs apply to the South African headquarter company, the headquarter company can elect different methods of credits for each treaty.[55]

It is submitted that the South African headquarter company may apply section 6*quat* as the DTA does not provide for the carry forward of excess foreign tax credits.

5.3.2. Section 6*quat* of the Income Tax Act

Section 6*quat* of the South African Income Act provides domestic relief in the form of a unilateral tax credit or rebate in respect of foreign taxes on foreign sourced income. Section 6*quat* also provides a tax deduction in respect of foreign taxes on South

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[55] South Africa. South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

African-sourced income.[56] The 6*quat* rebate and deduction are subject to certain limitations and criteria.

5.3.2.1. Rebate in respect of foreign taxes – credit method

The section 6*quat* rebate is available to a South African tax resident against its South African normal taxation where taxes have been paid on non-South African-sourced income in a foreign country and in South Africa. The section 6*quat* rebate is a deduction from an amount of South African normal taxation to be paid.

One of the requirements of section 6*quat*(1) is that the income received or accrued to the South African resident must be from a source outside of South Africa.

Without the use of a DTA, the section 6*quat* rebate will not be available to a South African headquarter company providing South African-sourced services to another African country as the source of the income received or accrued is in South Africa.

The DTAs between South Africa and Botswana, Ghana, Tunisia and Uganda provide a deemed source provision on technical or management fees where the source of technical or management fees are deemed to be in the country where the payer is resident, even though the actual source of services provided by the South African headquarter company may be in South Africa.

The deemed source rules in these DTAs are applied to section 6*quat*[57] and so the section 6*quat* rebate is available to the South African headquarter company for relief of double taxation in these circumstances.

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[56] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

[57] South Africa. South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

5.3.2.1.1. The calculation of the section 6quat rebate

In relation to where services are provided by a South African headquarter company to other African countries, Section 6*quat*(1A) provides that the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government other than South Africa. There must be no right of recovery of the tax by any person (other than a right of recovery in terms of any entitlement to carry back losses) and the source of the income received or accrued to the South African headquarter company must be outside of South Africa. Section 6*quat*(1B) provides that the rebate shall not in aggregate exceed an amount which bears to the total normal tax payable the same ratio as the total taxable income attributable to the income bears to total taxable income.

The section 6*quat* rebate is calculated as the lesser of the sum of the qualifying foreign taxes or the amount calculated under the limitation formula below:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Total taxable income derived from all sources}} \times \text{Normal tax payable on the total taxable income derived from all sources}$$ [58]

Section 6*quat*(2) provides that a section 6*quat* rebate cannot be claimed in addition to DTA relief. Section 6*quat*(4) provides for the translation of the foreign tax paid into South African Rands on the last day of that year of assessment by applying the average exchange rate for that year of assessment of the South African resident.

5.3.2.1.2. Relevant advantages of the section 6quat rebate

Section 6*quat*(5) provides for an adjustment to an income tax assessment of the South African resident within a period that does not exceed six years from the date of the original assessment in respect of that year. Taxes levied in African countries on technical or management services provided by South African residents are typically withheld upon payment of the service provided. As payment of the service can

[58] South Africa. South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

potentially be in a subsequent year to when the service income accrued to the South African resident, the six year limit provides the South African resident ample time to claim the section 6*quat* rebate. The six year limit also applies where an overstatement or understatement error in the calculation of the section 6*quat* rebate has occurred and a correction is required to be made to a previous year of assessment.

Where the sum of the foreign taxes proved to be payable exceeds the rebate claimed in a year of assessment, that excess amount may be carried forward to the immediate succeeding year of assessment where it can potentially qualify for a rebate against the normal income tax of the South African resident on taxable income from foreign sources in that year of assessment. The excess amount shall not be allowed to be carried forward for more than seven years from the year of assessment when the excess amount was carried forward for the first time.

5.3.2.1.3. Relevant disadvantages of the section 6quat rebate

Section 6*quat*(1A) provides that there must be no right of recovery of the foreign tax by any person (other than a right of recovery in terms of any entitlement to carry back losses). For example: a South African headquarter company provides technical services to another African country and a DTA in force deems the source of the service to be where the payer is resident and also provides that the other African country can levy a tax on the services which must not exceed, say, 10% of the gross amount. If the other African country levies a tax on the services at 15% of the gross amount of the fees, then the additional 5% tax that was levied is recoverable from the other African country and a section 6*quat* rebate cannot be claimed for the 5% excess amount of tax levied.

5.3.2.2. Deduction of foreign taxes on income – deduction method

The section 6*quat*(1C) deduction is a deduction of the foreign taxes against the income of a South African tax resident where taxes have been paid on South African-sourced income in a foreign country and in South Africa.

Section 6*quat*(1C) provides for the purpose of determining the taxable income derived by a South African resident from carrying on a trade, there may at the election of that resident be allowed as a deduction from the income of the resident so derived the sum of any foreign taxes on income (other than taxes contemplated in section 6*quat*(1A)) proved to be payable by that resident to any sphere of foreign government, without any right of recovery by any person other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to that assessment.

The section 6*quat* deduction provides partial relief for a South African resident from double taxation where foreign taxes are levied on South African-sourced income which is derived from trading operations. A South African resident may not choose between a section 6*quat* rebate and a section 6*quat* deduction. A section 6*quat* deduction is only available to the South African resident where a section 6*quat* rebate is not available to the South African resident. The section 6*quat* deduction effectively provides relief from double taxation on South African-sourced income of a South African resident where the income has been taxed in South Africa and in a foreign country. A South African resident may choose between a section 6*quat* deduction and a section 6*quin* rebate for double taxation relief where South African-sourced services have been provided by the South African resident and taxed in a foreign country.

Section 6*quat*(2) provides that a section 6*quat* deduction cannot be claimed in addition to DTA relief. Section 6*quat*(4) provides for the translation of the foreign tax paid into South African Rands on the last day of that year of assessment by applying the average exchange rate for that year of assessment of the South African resident.

5.3.2.2.1. The calculation of the section 6quat deduction

In relation to where South African-sourced services are provided by a South African headquarter company to other African countries, Section 6*quat*(1C) provides that determining taxable income of the headquarter company, upon election of the headquarter company, the headquarter company will be allowed a deduction from the income of the foreign tax proved to be payable to any sphere of government other than South Africa. There must be no right of recovery of the tax by any person (other than a right of recovery in terms of any entitlement to carry back losses). The source of the income received or accrued to the South African headquarter company must be within South Africa. Section 6*quat*(1D) provides that the deduction of the foreign tax payable shall not in aggregate exceed the total taxable income (before taking into account the deduction) attributable to income which is subject to the foreign tax. In determining the amount of taxable income attributable to income which is subject to the foreign tax, any allowable deductions under section 18A, deduction of donations to certain organisations, must be deemed to have been incurred proportionately in the ratio that income bears to total income.

5.3.2.2.2. Relevant advantages of the section 6quat deduction

Where a South African resident cannot claim a section 6*quat* rebate against foreign taxes paid in a foreign country as the income on which the foreign tax is levied is South African-sourced, the South African resident can claim a section 6*quat* deduction against taxable income, subject to certain limitations and criteria.

A South African resident may choose between a section 6*quat* deduction and a section 6*quin* rebate for double taxation relief where South African-sourced services have been provided by the South African resident and taxed in a foreign country.

5.3.2.2.3. Relevant disadvantages of the section 6quat deduction

Section 6*quat*(1C) provides that there must be no right of recovery of the foreign tax by any person (other than a right of recovery in terms of any entitlement to carry back losses). For example: a South African headquarter company provides South African-sourced services to another African country and a DTA in force provides that South Africa has the taxing rights on the service income. If the other African country levies a tax on the services at 15% of the gross amount of the fees, then the 15% tax that was levied is recoverable from the other African country and a section 6*quat* deduction cannot be claimed.

Any foreign taxes which are not deductible due to limitations under section 6*quat*(1D) are forfeited and do not qualify for any other deduction in that year of assessment.

The foreign taxes which are not deductible due to limitations under section 6*quat*(1D) cannot be carried forward to any subsequent year of assessment.

5.4. Mutual agreement procedures

Article 25 of the OECD MTC provides mutual agreement procedures for resolving discrepancies in the application of a DTA. The mutual agreement procedure, firstly, involves a taxpayer of a state of residence appealing to the tax authorities of that state where taxation has not been applied in accordance with a DTA. The mutual agreement procedure further involves the relevant competent authorities endeavouring by mutual agreement to resolve the discrepancies which have led to a taxpayer being subjected to taxation which is not in accordance with the DTA. The two competent authorities may consult with each other to resolve the interpretation or application of a DTA including cases of double taxation not dealt with in the DTA. The competent authorities may consult with either other in any form, directly with each other or through a joint commission appointed for the purpose.[59] The OECD MTC provides for an arbitration mechanism for the taxpayer where issues have not been resolved by the competent authorities within a certain timeframe, which is typically three years. Article 3 of the OECD MTC provides that a DTA between countries will contain each state's appointed competent authority.

5.4.1. Disadvantages of mutual agreement procedures

A taxpayer may utilise mutual agreement procedures as laid out in a DTA.

It appears that South African tax residents have not made extensive use of the mutual agreement procedure. This is evident from the table provided below which compares the number of cases initiated and the number cases open at the end of the OECD reporting period for South Africa, the United States and the United Kingdom.[60]

[59] OECD (2010). *OECD Model Tax Convention on Income and on Capital (Condensed version 2010)*. Paris: OECD Publications.
[60] OECD (n.d.). *Mutual Agreement Procedure Statistics for 2013*. Available from: http://www.oecd.org/ctp/dispute/map-statistics-2013.htm. (Accessed 12 October 2015).

	Number of New Cases					
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
South Africa	4	1	5	5	3	2
United Kingdom	44	56	68	54	69	79
United States	308	326	252	279	236	403
	Number of Open Cases at the End of Reporting Period					
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
South Africa	0	1	4	6	6	6
United Kingdom	126	120	131	133	143	160
United States	578	724	705	686	573	732

Table 4: Mutual Agreement Procedure statistics for South Africa, the United Kingdom and the United States of America

In the case where South African-sourced services are provided by a South African tax to another African country and the service income is taxed in South Africa and the other African country which is not in accordance with the DTA between the two countries, a mutual agreement procedure can be requested by the South African tax resident to resolve the double taxation case. The South African tax resident may apply for a mutual agreement procedure irrespective of domestic remedies.[61] The South African tax resident may pursue domestic remedies at the same time as the mutual agreement procedures. If the dispute cannot be solved unilaterally, then the South African competent authority will be required to approach the competent authority of the other African country to resolve the dispute.

The South African tax resident does not have a right to present the case at hand or appear before the authorities. The mutual agreement procedure is a process by which the two competent authorities endeavour to resolve the dispute. There is no obligation for the competent authorities to resolve the dispute which has made the outcomes of the mutual agreement procedure uncertain.[62] As cited by Olivier and Honiball (2011), “the usefulness of the mutual agreement procedure has been questioned:

[61] Article 25(1) of the OECD Model Tax Convention.
[62] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

'… It generally takes a long time and it is the tax authorities that control the procedure; the taxpayer enjoys no particular legal protection. The taxpayer has neither the right to demand a mutual agreement procedure nor to demand the elimination of taxation contravention principles. The taxpayer has no right to be heard or to otherwise be involved, and has no right to be informed of the decision itself or the grounds on which it was taken. Moreover, there is no obligation to disclose the agreement. The absence of mandatory problem resolution is the largest disadvantage of the procedure.' (Runge 'Mutual Agreement Procedures and the Role of the Taxpayer' 2002 Internal Bureau of Fiscal Documentation 16 at 17)"

Article 25(2) of the OECD MTC provides that the agreement or resolution reached between the two competent authorities shall be implemented. In *IRC v Commerzbank AG* [1991]*; IRC v Banco do Brazil SA* [1990] STC 285 at 302b it was held that the decisions of the competent authorities were merely views of tax authorities and had no authority in the English courts. The South African tax resident who has been aggrieved by a decision of the competent authorities may approach a Court as the South African tax resident is not bound by the outcome of the mutual agreement procedure as the outcome of the mutual agreement procedure is an agreement between the two tax authorities only.[63]

Article 25(5) of the OECD MTC provides for an arbitration mechanism for the taxpayer where issues have not been resolved by the competent authorities within a certain timeframe, which is typically three years. All of the DTA's in place between South Africa and other African countries do not contain this paragraph nor an equivalent.

[63] Olivier, L & Honiball, M. (2011). *International Tax: A South African Perspective*. Cape Town: Siber Ink.

5.4.2. Recent developments by SARS

On 6 October 2015, SARS provided a new page on the SARS website which explains how the mutual agreement procedure operates in accordance with a DTA.[64] It also provides what information is required from the taxpayer for mutual agreement procedure requests and provides the functions of a competent authority.

It is submitted that by providing clarity on the mutual agreement procedure process, South African resident taxpayers will utilise the mutual agreement procedure where a South African resident taxpayer has been subjected to double taxation which is not in accordance with a DTA.

5.5. Section 6*quin* of the Income Tax Act

5.5.1. Introduction of section 6*quin*

The South African Treasury recognised that withholding taxes in respect of services being provided from South Africa were being imposed by a number of African jurisdictions even where tax treaties prescribed otherwise. The result is that the withholding taxes on services provided from South Africa attracted double taxation with little relief for the South African taxpayer. This practice goes against South Africa's objective in becoming a regional financial centre[65] and, consequently, South Africa's objective in attracting MNE group headquarter companies.

In 2011, the South African Treasury introduced foreign tax rebate for South African-sourced service fees charged to other countries in the form of section 6*quin* of the South African Income Tax Act[66]. Section 6*quin* became effective from 1 January 2015 and is applicable in respect of amounts of tax withheld or imposed by any sphere of

[64] South African Revenue Service (2015). *Mutual Agreement Procedure (MAP).* Available from: http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/Mutual-Agreement-Procedure.aspx (Accessed 25 October 2015).
[65] South Africa. National Treasury (2012). *Explanatory Memorandum on the Taxation Laws Amendment Bill 2011*. Available from: http://www.treasury.gov.za/legislation/acts/2011/EM%20for%20Taxation%20Laws%202011%20dated%2030%20Jan%202012.pdf (Accessed 23 August 2015).
[66] No. 58 of 1962.

government of any country other than the Republic of South Africa during years of assessment commencing on or after that date.

Where, subject to certain criteria and limitations, section 6*quat* provides a foreign tax rebate for foreign taxes paid on foreign sourced services income provided by a South African tax resident company and a tax deduction for foreign taxes paid on South African-sourced services income provided by a South African tax resident company, section 6*quin* provides a foreign tax rebate for foreign taxes paid on South African-sourced services income.

5.5.2. The calculation of the section 6*quin* foreign tax rebate

Section 6*quin* (1), (2) and (4) provide the calculation of the section 6*quin* foreign tax rebate:

‘(1) Subject to subsection (3) and (3A), where any portion of the taxable income of a resident is attributable to an amount that is from a source within the Republic and is received by or accrued to that resident in respect of services rendered within the Republic, and an amount of tax in respect of that amount is—

(a) (i) levied by any sphere of government of any country—

(aa) other than the Republic; and

(bb) with which the Republic has concluded an agreement for the avoidance of double taxation; and

(ii) withheld when the amount is paid to that resident by the person making the payment; or

(b) imposed by any sphere of government of any country—

(aa) other than the Republic; and

(bb) with which the Republic has not concluded an agreement for the avoidance of double taxation, in terms of the laws of that country,

a rebate determined in accordance with subsection (2) must be deducted from the normal tax payable by that resident.

(2) (a) For the purposes of paragraph (a) of subsection (1), the rebate is an amount equal to the lesser of—

(i) the amount of normal tax which is attributable to the amount received or accrued as contemplated in that subsection; or

(ii) the amount of tax levied and withheld as contemplated in that paragraph.

(b) For the purposes of paragraph (b) of subsection (1), the rebate is an amount equal to the lesser of—

(i) the amount of normal tax which is attributable to the amount received or accrued as contemplated in that subsection; or

(ii) the amount of tax imposed as contemplated in that paragraph.

(4) For the purposes of subsection (2)(a)(ii) and (b)(ii), the amount of any tax—

(a) levied and withheld as contemplated in subsection (1)(a); or

(b) imposed as contemplated in subsection (1)(b),

must be translated to the currency of the Republic on the last day of the year of assessment in which that tax is so levied and withheld or imposed, by applying the average exchange rate for that year of assessment.'

A section 6*quin* foreign tax rebate is only available on South African-sourced services income. Technically the section 6*quin* foreign tax rebate is calculated on each amount of South African-sourced service income which has been subject to withholding tax in a foreign jurisdiction. Practically, SARS allows for the calculation to be performed per service contract per year of assessment.[67] The foreign tax rebate is limited to an amount equal to the lesser of the South African normal tax attributable to the amount received for the service provided or the amount of tax withheld by the foreign jurisdiction. If the payer of the South African-sourced service withholds more than what is levied by the foreign government, the excess amount withheld by the payer will not qualify for a foreign tax rebate. "Imposed by any sphere of government" provides that the foreign tax rebate is limited to a tax amount that a foreign government levies on the service provided.

[67] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

As mentioned above, the foreign tax rebate is limited to an amount equal to the lesser of the South African normal tax attributable to the amount received for the service provided or the amount of tax withheld by the foreign jurisdiction. A calculation is, therefore, required to determine the South African normal tax attributable to the amount received for the service provided. A *"pro rata"* method is applied whereby the amount of attributable tax is determined by apportioning the total normal tax payable in the ratio that the relevant amount of taxable service income bears to total taxable income.[68] The South African normal tax attributable to the amount received for the service provided is thus calculated as:

$$\frac{\text{Taxable income per service contract falling under s6}\textit{quin}\text{ per country}}{\text{Taxable income derived from all sources}} \times \text{Normal tax payable}$$ [69]

"Taxable income per service contract falling under 6*quin* per country" refers only to countries which have withheld tax on South African-sourced services provided.

In determining taxable income per service contract, any deductible expenditure incurred directly related to the service contract income must be deducted from such income and a portion of general deductible expenditure incurred which is not directly related to the service contract income or other income of the South African tax resident company, must be apportioned on a fair and reasonable basis between the service contract income and the other income of the South African tax resident.[70]

Section 6*quin*(4) provides that the foreign tax rebate must be translated into South African Rands on the last day of the year of assessment in which that tax is levied and withheld or imposed, by applying the average exchange rate for that year of assessment.

[68] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).
[69] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).
[70] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

5.5.3. Section 6*quin* foreign tax rebate limitations and return requirements

Section 6*quin*(3) and (3A) provide certain limitations and return requirements:

> *'(1) No rebate may be deducted in terms of this section if—*
>
> *(a) the amount of tax levied and withheld as contemplated in subsection (1)(a);*
>
> *(b) the amount of tax imposed as contemplated in subsection (1)(b); or*
>
> *(c) any portion of any amount contemplated in paragraph (a) or (b), is—*
>
> *(i) taken into account in determining any amount of any rebate that is, in terms of section 6quat (1), deducted from the normal tax payable by that resident; or*
>
> *(ii) deducted from the income of that resident in terms of section 6quat (1C).'; and*

> *'(3A) Where an amount of tax is levied and withheld as contemplated in subsection 1(a), no rebate may be deducted in terms of this section if the resident contemplated in subsection (1) does not, within 60 days from the date on which that amount of tax is withheld, submit to the Commissioner a return that the amount of tax was levied and withheld as contemplated in subsection (1)(a).'*

Where foreign tax on South African-sourced services is deducted from South African normal taxation of the South African taxpayer or where the South African taxpayer has elected under section 6*quat*(1C) to deduct from income the foreign tax withheld, no foreign tax rebate is allowable under section 6*quin*.

Section 6*quin*(3A) is effective from 1 July 2013[71] and required the South African taxpayer to submit to the Commissioner a return within 60 days from the date on which the foreign tax was withheld on the South African-sourced service income. The

[71] Date determined by the Minister of Finance in Notice No. 463; *Government Gazette* No. 36627 (02 July 2013).

required return of foreign tax held is the SARS referenced FWT01 return. The return requires information such as: the taxpayer details, the nature of services rendered, the gross income of the services rendered, the amount of foreign tax withheld, the year of assessment during which the services were rendered, the date on which the foreign tax was withheld, the foreign tax authority details, and answers to questions such as:

- Is a double taxation agreement in force between the two countries?
- Does the law of the foreign country provide for the imposition of such withholding tax?
- Has the South African taxpayer approached the relevant revenue authority and raised his concern regarding the tax levied?

If the foreign revenue authority was approached, then the taxpayer is required to inform SARS of the outcomes and furnish relevant correspondence. The FWT01 return also noted that documentary proof in respect of the foreign taxes paid was required, for example, assessments, receipts and tax certificates.

Interpretation Note No. 18 (Issue 3) provides that, where there is a DTA in force between South Africa and the country where tax is withheld on South African-sourced service income which is not in accordance with the DTA, the South African taxpayer must first approach the foreign tax authority to determine whether the foreign tax has been erroneously withheld and will be corrected or whether there is a dispute which requires resolution. SARS requires the information provided on the FWT01 returns to reduce or eliminate the foreign tax on South African-sourced service income where the foreign tax has been erroneously withheld in accordance with the DTA between the two countries. SARS will engage in mutual agreement procedures in accordance with the DTA in order to resolve the matter. Provided that all the requirements of section 6*quin* have been met, the enquiries by the South African taxpayer to the foreign tax authority and the mutual agreement procedures conducted by SARS will not delay the section 6*quin* foreign tax rebate from being claimed by the South African taxpayer against the tax withheld by foreign tax authorities on South African-sourced service income.

5.5.4. Foreign taxes refunded or foreign tax liabilities discharged

Section 6*quin*(5) provides the treatment of foreign taxes refunded or foreign tax liabilities discharged:

> *'(5) Where, during any year of assessment, a rebate has been deducted in terms of this section from the normal tax payable by a resident as a result of any amount of tax having been—*
>
> *(a) levied and withheld as contemplated in subsection (1)(a); or*
>
> *(b) imposed as contemplated in subsection (1)(b),*
>
> *and, in any year of assessment subsequent to that year of assessment, the resident—*
>
> *(i) receives any amount by way of refund in respect of the amount of tax so levied and withheld; or*
>
> *(ii) is discharged from any liability in respect of the amount of tax so imposed,*
>
> *so much of the amount so received or the amount of that discharge as does not exceed that rebate must be deemed to be an amount of normal tax payable by that resident in respect of that subsequent year of assessment.'*

It could happen that where a DTA is in force between South Africa and the country in which tax was withheld by the foreign tax authority on South African-sourced service income, the foreign tax authority refunds the tax withheld. This may happen due to mutual agreement procedures that were conducted. It also could happen where there is no DTA in force between South Africa and the country in which tax was withheld by the foreign tax authority on South African-sourced service income, that the foreign tax authority discharges the tax withheld.[72]

In these circumstances, if a foreign tax rebate has previously been claimed by a South African taxpayer, the tax refunded or discharged that does not exceed the rebate claimed will be South African normal tax payable in the year of assessment in which

[72] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).

the refund or discharge occurred. The amount deemed to be normal tax payable is not reduced by an assessed loss.

Section 6*quin* does not prescribe the manner in which the tax refunded or discharged by the foreign tax authority is translated into South African Rands. It is submitted that the general translation rule in section 25D will apply in order to translate the tax refunded or discharged by the foreign tax authority into South African Rands.[73]

5.5.5. Advantages of the section 6*quin* foreign tax rebate

One of the objectives of the introduction of the 6*quin* rebate was to encourage MNE groups to headquarter in South Africa and increase South Africa's attractiveness to become a regional financial centre.[74] National Treasury did not implement no tax on head office services rendered at the South African head office to the MNE group companies as presented by the Katz Commission (cf. 2.2). The section 6*quin* rebate provides relief from double taxation where South African-sourced services provided by South African companies are taxed in other African countries. Section 6*quat(1C)* provides a tax deduction where South African-sourced services provided by South African companies are taxed in other African countries. The tax deduction is limited to the taxable income attributable to the service income, before taking into account the section 6*quat* deduction. The section 6*quin* rebate provides a tax credit which is limited to the amount of South African normal tax attributable to the service income. Choosing to claim a foreign tax rebate under section 6*quin* potentially is more beneficial than claiming a deduction under section 6*quat*(1C) but this is not necessarily so. Unlike section 6*quat* where if there is a right of recovery from the other African country, no foreign tax rebate is allowable, the section 6*quin* rebate can be claimed, irrespective of whether there is a right of recovery from the other African country. This is particularly useful where other African countries have incorrectly withheld tax on South African-sourced service income provided by a South African company and also where

[73] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).
[74] South Africa. National Treasury (2012). *Explanatory Memorandum on the Taxation Laws Amendment Bill 2011.* Available from: http://www.treasury.gov.za/legislation/acts/2011/EM%20for%20Taxation%20Laws%202011%20dated%2030%20Jan%202012.pdf (Accessed 23 August 2015).

other African countries have incorrectly withheld tax on South African-sourced service income provided by a South African company which is not in accordance with a DTA in force between the two countries. The South African company has comfort that there is relief from double taxation despite the outcome of mutual agreement procedures.

5.5.6. Disadvantages of the section 6*quin* foreign tax rebate

Unlike the foreign tax credit under section 6*quat*(1A), the foreign tax rebate can only be claimed in the year of assessment in which the foreign tax is proved to be payable to the government of any other country. Any excess foreign taxes cannot be carried forward to a subsequent year of assessment and cannot be deducted under section 6*quat*(1C) or section 11(a) read with section 23(g) or any other section of the Income Tax Act.[75]

Although it is submitted that SARS requires the information provided on the FWT01 return to reduce or eliminate the foreign tax on South African-sourced service income where the foreign tax has been erroneously withheld in accordance with the DTA between the two countries, the FWT01 return must be completed by all South African taxpayers requiring to claim a foreign tax rebate under section 6*quin*. In other words, even when a DTA is not in force between the two countries, a FWT01 return must be completed by the South African taxpayer in order to claim a foreign tax rebate under section 6*quin*.

Submitting the FWT01 form within 60 days from the date on which the foreign tax was withheld on the South African-sourced service income including the required supporting documentation in the form of assessments, receipts and tax certificates was said to be problematic.[76] With regular occurrence it is difficult for South African taxpayers to obtain proof from the foreign tax authorities of the foreign withholding

[75] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015).
[76] PricewaterhouseCoopers (2013). *Foreign Tax Rebate Reporting Requirement.* Available from: https://www.pwc.co.za/en/assets/pdf/tax-alert-08-july-2013.pdf (Accessed 7 November 2015).

taxes paid within the 60 day time frame.[77] Without the required supporting documentation, the section 6*quin* rebate cannot be claimed.

5.5.7. The proposed withdrawal of section 6*quin*

The Katz Commission recognised that South Africa could benefit from MNE groups headquartering in the country. The advantages included that foreign companies or multinational companies will be encouraged to invest and expand into Africa through South Africa. There will be benefit for South Africa being able to recruit and maintain skills which will ultimately contribute to the economy.[78]

The Katz Commission presented as a key fiscal attribute of a regime conducive to the formation of international headquarter and service companies, that there should be no tax on head office services rendered at the head office to the multi-national group.[79]

It is submitted that the South African Treasury could not provide tax legislation where there is no tax on head office services rendered at the South African head office to MNE groups as Treasury did not want to be classified as a low-tax jurisdiction or tax haven which may have negative consequences.

In order to encourage MNE groups to headquarter in South Africa, and consistent with South Africa's objective to become a regional financial centre, section 6*quin* was introduced to reduce or eliminate double taxation on South African-sourced services provided from South African companies. Section 6*quin* became effective from 1 January 2015 and is applicable in respect of amounts of tax withheld or imposed by any sphere of government of any country other than the Republic of South Africa during years of assessment commencing on or after that date.

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[77] Bell, E. (2015). *The sun sets on the section 6quin tax rebate.* Available from: http://www.thesait.org.za/news/218632/The-sun-sets-on-the-section-6quin-tax-rebate.htm (Accessed 7 November 2015).

[78] Katz Commission (1997). *Fifth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.* (par 7.1.1).

[79] Katz Commission (1997). *Fifth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.* (par 7.1.5).

On 22 July 2015, the Draft Taxation Laws Amendment Bill, 2015 proposed the withdrawal of section 6*quin*. The Draft Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015 explained that the foreign tax rebate provided in section 6*quin* is a departure from international tax rules and tax treaty principles. The explanatory memorandum further explained:

> '… *it encourages treaty partners not to abide by the terms of the tax treaty in respect of the taxation of fees and thus give them taxing rights over income that is not sourced in those countries. Consequently, it defeats the whole purpose of the tax treaty.'*
>
> and
>
> '…*the Davis Committee Interim Report on Action 6: "Preventing Treaty Abuse" in its discussion of section 6quin "Base erosion resulting from South Africa giving away it tax base" states that "South Africa has effectively eroded its own tax base as it is obliged to give a credit for taxes levied in the paying country.'*

It appears that the National Treasury is concerned about treaty partners taxing South African-sourced services provided from South African companies and this is not consistent with DTAs South Africa has with other countries. This statement is inconsistent with the DTAs in force between South Africa and Botswana, Ghana, Tunisia and Uganda where the DTAs deem the source of management or technical fees to arise in the country where *the payer* is resident, irrespective of where the actual source of the services is. Management fees and technical fees in these DTAs generally refer to administrative, technical, managerial or consultancy in nature services.

5.6. Conclusion

When South African-sourced services are provided by a South African headquarter company to African countries, withholding tax is often levied when payment is made to the South African headquarter company by the recipient of the service. South African companies are taxed on their world-wide income. The South African taxpayer can obtain relief from double taxation with the utilisation of DTAs and, unilaterally, with the use of domestic legislation.

From the research conducted on DTAs between South Africa and other African countries, it is clear that relief from double taxation for the South African taxpayer providing South African-sourced services varies with the utilisation of different DTAs.

Although internationally it appears to be generally accepted that the source of services is where the service is provided, some DTAs between South African and other African countries allocate the taxing right to the state where the payer is resident. The South African taxpayer may be able to utilise the DTA or utilise section 6*quat*(1A) for the relief of double taxation in this case.

Unilateral relief from double taxation can be obtained with the use of either the section 6*quat* rebate, section 6*quat* deduction, or the section 6*quin* rebate. Where South African-sourced services are provided by a South African headquarter company to other African countries, the section 6*quat* rebate is limited to withholding tax on services provided to countries where the DTA with South Africa provides that the source of the service is deemed to be in the state of the payer. In most cases, the South African taxpayer will need to choose between the section 6*quat* deduction and the section 6*quin* rebate. The section 6*quin* rebate provides two strong advantages over the use of section 6*quat* deduction. Firstly, the section 6*quin* rebate provides better double taxation relief because the relief is a credit against income tax payable by the South African taxpayer. The section 6*quat* deduction is a deduction against taxable income of the South African taxpayer. Secondly, there is a requirement in section 6*quat*(1C)[80] that the deduction can only be claimed if there is no right of recovery of the foreign tax by any person (other than a right of recovery in terms of any entitlement to carry back losses). Section 6*quin*[81] does not require there to be no right of recovery of the foreign tax by any person. Where African countries withhold tax on South African-sourced services incorrectly, the South African taxpayer can either approach the relevant foreign revenue authority to correct the tax withheld; apply

[80] Section 6*quat* deduction.
[81] Section 6*quin* rebate.

for assistance of competent authorities through mutual agreement procedure in accordance with a DTA to correct the tax withheld; or obtain double taxation relief with the application of section 6*quin.* It is submitted that approaching the relevant foreign revenue authority may not achieve the required result of the correction of the tax withheld. It is submitted that applying for assistance of competent authorities through mutual agreement procedure in accordance with a DTA is a cumbersome process which may not achieve the required outcome of the correction of tax withheld.

If section 6*quin* is withdrawn from the Income Tax Act, headquarter companies providing South African-sourced services to other African countries will be disadvantaged as they will potentially be exposed to double taxation. The double taxation increases the cost of providing services to the African countries from South Africa.

Chapter 6 – An analysis of the cost of double taxation

6.1. Introduction

South African-sourced services provided by South African companies to other African countries often are taxed in the other African countries by means of a withholding tax on the gross amount paid for the service and are also taxed in South Africa. Subject to certain criteria and limitations, a section 6*quat* deduction or section 6*quin* rebate is available to reduce the double tax burden MNE groups will be subjected to if they headquarter in South Africa.

The DTAs between South Africa and Botswana, Ghana, Tunisia and Uganda provide a deemed source provision on technical or management fees where the source of technical or management fees is deemed to be in the country where the payer is resident. Subject to certain criteria and limitations, the section 6*quat* rebate is available to reduce the effects of double taxation.

This chapter analyses the cost of double taxation in a number of scenarios by means of a case study if MNE groups choose to headquarter in South Africa, as opposed to a lower tax jurisdiction.

6.2. Transfer pricing of management and administration fees charged to group companies

Typically a headquarter company will charge group companies a fee for the services provided to those companies.

Services provided by a South African headquarter company to other African countries will be subject to transfer pricing legislation in South Africa and, potentially, in the other African country. When calculating the arm's length price to be charged between associated companies, consideration is required from both the service provider perspective and the service recipient perspective. Consideration is required on the value of the service provided and the cost to the service provider and what the recipient of the service would be willing to pay for the service if the service were provided by an independent company.

On 3 November 2014 the OECD released a discussion draft of the proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services.[82] The discussion draft provides for services qualifying as low value-adding intra-group services benchmarked at a uniform mark up of between 2% and 5%. No further benchmarking would be necessary. The services qualifying as low value-adding intra-group services are services performed by one member or more than one member of an MNE group (typically headquarter companies or shared services companies) on behalf one or more other group members which:

- are of a supportive nature;
- are not part of the core business of the MNE group;
- do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and
- do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk.

Although the above defined services incorporate services provided by a headquarter company to MNE group companies, there are many typical head office services which may not fall into the low value-adding intra-group service definition.[83] These services may include information technology, financial product services and other specialised consultancy services which tend to be high margin technical services. It is submitted that arm's length mark up on costs for these services would typically be above 5% due to the specialised nature of these services.

For the analysis case study presented below of the cost of double taxation, a 3% mark up on costs will be used for the low value-adding intra-group services provided from a

[82] OECD (2014). *BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services.* Available from: http://www.oecd.org/ctp/transfer-pricing/discussion-draft-action-10-low-value-adding-intra-group-services.pdf (Accessed 8 November 2015).
[83] Daya, L & Visser, L. (2015) *Part 2: the pitfalls of cross-border service arrangements – what you need to know* Available from: https://www.ensafrica.com/news/Part-2-the-pitfalls-of-cross-border-service-arrangements-what-you-need-to-know?Id=1871&STitle=tax%20ENSight (Accessed 8 November 2015).

South African headquarter company of an MNE group, and a 25% mark up on costs will be used for high margin technical services.

6.3. Case study parameters for the cost analysis calculation

1. The headquarter company of an MNE group is incorporated in South Africa and provides South African-sourced services to companies within the MNE group which reside in other African countries.
2. The headquarter company does not provide any services to South African companies.
3. The headquarter company provides low value-adding intra-group services at a mark-up on costs of 3%.
4. The headquarter company provides high margin intra-group services at a mark-up on costs of 25%.
5. All costs/expenses are tax deductible in South Africa.
6. The headquarter company incurs employment costs of 70% of total costs based on a sample of South African headquarter companies.
7. The effective tax rate on employee costs is 31% based on a sample of South African headquarter companies.
8. Where a DTA is in force between South Africa and the other African country to which the services are provided and according to that DTA no tax must be levied on those services by the other African country, the case study provides an analysis of the tax burden when the other African country has incorrectly withheld tax upon payment of the services provided by the South African headquarter company.
9. All withholding taxes in the other African Countries are translated into South African Rands. No foreign exchange differences are calculated.

6.4. The case study analysis of the cost of double taxation

The tables below set out the tax burden on the South African headquarter company on South African-sourced services provided to an associated company within the MNE group residing in another African country. The tables below also provide a comparison of the tax burden applying the section 6*quat*(1C) tax deduction and the section 6*quin* tax rebate. Where a deeming source provision in the DTA between South Africa and the other African country provides that the source of income is the country in which the payer of the service resides, the table provides the tax burden applying the section 6*quat*(1A) rebate.

A calculation is provided of taxes that would not be available to SARS if section 6*quin* were to remain effective and taxes that would not be available to SARS if the headquarter company were relocated to another jurisdiction.

6.4.1. South African-sourced services provided to Angola

There is currently no DTA in force between South Africa and Angola. Angola levies a 6.5% withholding tax on the gross amount of services fees paid to non-residents. The tax is levied irrespective of the source of the service.

ANGOLA		**Low Margin Services ZAR**		**High Margin Services ZAR**
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		650 000		650 000
Cost of South African normal tax with Section 6*quat* (1C) deduction		-		378 000
Cost of South African normal tax with Section 6*quin* rebate		-		-
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction	223.17%	650 000	51.40%	1 028 000
Total cost of taxes with section 6*quin* rebate	223.17%	650 000	32.50%	650 000
Total cost of taxes if headquarter company relocated to a tax haven	223.17%	650 000	32.50%	650 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin*		-		378 000
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 5: Services to Angola: summary of tax burden

In the analysis above, there is no tax benefit in applying section 6*quin* over section 6*quat*(1C) for the low margin services. When applying section 6*quin* over section 6*quat*(1C) for the high margin services there is a R378 000 tax saving for the headquarter company. Due to the withholding tax levied by the tax authorities of Angola on the gross amount of the services fees, the effective tax rates are high on the services provided by the headquarter to the associated company in Angola of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate is 223.17% irrespective of the use of the section 6*quat*(1C) deduction or the section 6*quin* rebate. On the high margin services provided by the headquarter company, the effective tax rate is 51.4% if the section 6*quat* deduction is utilised and 32.5% of the section 6*quin* rebate is utilised.

If the section 6*quin* rebate were to remain effective, SARS would forfeit R378 000 of income tax on the high margin services and would not forfeit any income tax on the low margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Angola does not benefit with the application of section 6*quin* on low margin services over the application of section 6*quat*(1C). On high margin services to Angola, the headquarter company benefits with the application of section 6*quin* over the application of section 6*quat*(1C). Section 6*quin* is more effective in reducing double taxation is this case and could incentivise a MNE group to headquarter in South Africa based on the reduced cost of providing South African-sourced services to Angola.

Calculations are provided in Appendix 1.1: Calculation of taxation on South African-sourced services provided to Angola.

6.4.2. South African-sourced services provided to Botswana

There is currently a DTA in force between South Africa and Botswana. Botswana levies a 15% withholding tax on the gross amount of services fees paid to non-residents. Article 20 of the DTA deems technical fees to arise in a Botswana when the payer is a resident of Botswana. If South African-sourced services are provided from South Africa to Botswana, the services are deemed to arise in Botswana if payment is made from Botswana for the services. The Article limits the tax charged in the Botswana to 10 per cent of the gross amount of such fees. Technical fees arising, or deemed to arise, in Botswana which are derived by a resident of South Africa may be taxed in South Africa. Because the DTA deems the source of the technical fees to be where the payer resides, being Botswana, the South African taxpayer will be able to utilise the section 6*quat*(1A) rebate to reduce the effects of double taxation.[84]

Technical fees are defined in the Article as:

> "*payments of any kind… in consideration for any services of an administrative, technical, managerial or consultancy nature*.' [emphasis added]

[84] South African Revenue Service (2015). *Interpretation Note No.18 (Issue 3), Rebates and Deduction for Foreign Taxes on Income.* Available from: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf (Accessed 30 August 2015)

BOTSWANA	Low Margin Services ZAR		High Margin Services ZAR	
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		1 000 000		1 000 000
Cost of South African normal tax with Section 6*quat(* 1A) rebate		-		-
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1A) rebate	343.33%	1 000 000	50.00%	1 000 000
Total cost of taxes if headquarter company relocated to a tax haven	343.33%	1 000 000	50.00%	1 000 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin*	N/A		N/A	
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 6: Services to Botswana: summary of tax burden

The analysis above does not provide that differences between section 6*quin* and section 6*quat*(1C) because these section are not available to the South African taxpayer to reduce double taxation. Section 6*quin* and section 6*quat*(1C) requires the service provided to be South African-sourced. The DTA between South Africa and Botswana deems the source of the service provided to be in Botswana if the payer of the service resides in that country. The South African headquarter company will thus be able to utilise the section 6*quat*(1A) rebate against the 10% withholding tax in Botswana on technical services to reduce the effects of double taxation.

Due to the withholding tax levied by the tax authorities of Botswana on the gross amount of the services fees, the effective tax rates are high on the services provided by the headquarter to the associated company in Botswana of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate is 343.33% if the section 6*quat*(1A) rebate is utilised. On the high margin services provided by the headquarter company, the effective tax rate is 50% if the section 6*quat*(1A) rebate is utilised.

Although the section 6*quin* rebate is not utilised in the analysis above, if the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Botswana does not benefit with the application of section 6*quin* because section 6*quat* (1A) is available to the headquarter company to reduce double taxation. Section 6*quin* would not incentivise a MNE group to headquarter in South Africa if it were available for use.

Calculations are provided in Appendix 1.2: Calculation of taxation on South African-sourced services provided to Botswana.

6.4.3. South African-sourced services provided to Kenya

There is currently a DTA in force between South Africa and Kenya. Kenya levies a 20% withholding tax on the gross amount of services fees paid to non-residents. There is no Article in the DTA that deals specifically with technical and management fees. Article 7 of the DTA provides that all profits of an enterprise of South Africa shall be taxable only in South Africa unless the enterprise carries on business in Kenya through a permanent establishment situated therein. In accordance with the DTA, a South African headquarter company providing South African-sourced services to an associated company of an MNE group should be taxed in South Africa only.

KENYA	Low Margin Services ZAR		High Margin Services ZAR	
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		2 000 000		2 000 000
Cost of South African normal tax with Section 6*quat* (1C) deduction - DTA not adhered to		81 553		560 000
Cost of South African normal tax with Section 6*quin* rebate - DTA not adhered to		-		-
Cost of South African normal tax if the DTA in force is adhered to		81 553		560 000
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction - DTA not adhered to	714.67%	2 081 553	128.00%	2 560 000
Total cost of taxes with section 6*quin* rebate - DTA not adhered to	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes if headquarter company relocated to a tax haven	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes if the DTA in force is adhered to	28.00%	81 553	28.00%	560 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin* when the DTA in force is not adhered to		81 553		560 000
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 7: Services to Kenya: summary of tax burden

In the analysis above, when applying section 6*quin* over section 6*quat*(1C) for low margin services there is a R81 553 tax saving for the headquarter company. When applying section 6*quin* over section 6*quat*(1C) for the high margin services there is a R560 000 tax saving for the headquarter company. If the tax authorities of Kenya do not adhere to the DTA, the withholding tax levied by the tax authorities of Kenya are levied on the gross amount of the services fees and so the effective tax rates are high on the services provided by the headquarter to the associated company in Kenya of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate would be 686.67% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Kenya. The effective tax rate would increase to 714.67% if the section 6*quin* rebate is not available for use. On the high margin services provided by the headquarter company, the effective tax rate would be 100% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of

Kenya. The effective tax rate would increase to 128% if the section 6*quin* rebate is not available for use. If the tax authorities adhered to the DTA in force between South Africa and Kenya, no withholding tax would be levied on the South African-sourced services provided by the headquarter company in South Africa. The services provided would be included in gross income for South African normal tax purposes and the effective tax rate would be 28%.

If the section 6*quin* rebate were to remain effective, SARS would forfeit R81 533 of income tax on the low margin services and would forfeit R560 000 of income tax on the low margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Kenya benefits with the application of section 6*quin* on low margin services and high margin services over the application of section 6*quat*(1C) if the Kenyan tax authorities withhold tax on the services incorrectly. Section 6*quin* is more effective in reducing double taxation is this case and could incentivise a MNE group to headquarter in South Africa based on the reduced cost of providing South African-sourced services to Kenya.

Calculations are provided in Appendix 1.3: Calculation of taxation on South African-sourced services provided to Kenya.

6.4.4. South African-sourced services provided to Mozambique

There is currently a DTA in force between South Africa and Mozambique. Mozambique levies a 20% withholding tax on the gross amount of services fees paid to non-residents. There is no Article in the DTA that deals specifically with technical and management fees. Article 7 of the DTA provides that all profits of an enterprise of South Africa shall be taxable only in South Africa unless the enterprise carries on business in Mozambique through a permanent establishment situated therein. In accordance with the DTA, a South African headquarter company providing South African-sourced services to an associated company of an MNE group should be taxed in South Africa only.

MOZAMBIQUE	Low Margin Services	ZAR	High Margin Services	ZAR
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		2 000 000		2 000 000
Cost of South African normal tax with Section 6*quat* (1C) deduction - DTA not adhered to		81 553		560 000
Cost of South African normal tax with Section 6*quin* rebate - DTA not adhered to		-		-
Cost of South African normal tax if the DTA in force is adhered to		81 553		560 000
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction - DTA not adhered to	714.67%	2 081 553	128.00%	2 560 000
Total cost of taxes with section 6*quin* rebate - DTA not adhered to	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes if headquarter company relocated to a tax haven	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes if the DTA in force is adhered to	28.00%	81 553	28.00%	560 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin* when the DTA in force is not adhered to		81 553		560 000
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 8: Services to Mozambique: summary of tax burden

In the analysis above, when applying section 6*quin* over section 6*quat*(1C) for low margin services there is a R81 553 tax saving for the headquarter company. When applying section 6*quin* over section 6*quat*(1C) for the high margin services there is a R560 000 tax saving for the headquarter company. If the tax authorities of Mozambique do not adhere to the DTA, the withholding tax levied by the tax authorities of Mozambique are levied on the gross amount of the services fees and so the effective tax rates are high on the services provided by the headquarter to the associated company in Mozambique of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate would be 686.67% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of

Mozambique. The effective tax rate would increase to 714.67% if the section 6*quin* rebate is not available for use. On the high margin services provided by the headquarter company, the effective tax rate would be 100% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Mozambique. The effective tax rate would increase to 128% if the section 6*quin* rebate is not available for use. If the tax authorities adhered to the DTA in force between South Africa and Mozambique, no withholding tax would be levied on the South African-sourced services provided by the headquarter company in South Africa. The services provided would be included in gross income for South African normal tax purposes and the effective tax rate would be 28%.

If the section 6*quin* rebate were to remain effective, SARS would forfeit R81 533 of income tax on the low margin services and would forfeit R560 000 of income tax on the low margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Mozambique benefits with the application of section 6*quin* on low margin services and high margin services over the application of section 6*quat*(1C) if the tax authorities in Mozambique withhold tax on the services incorrectly. Section 6*quin* is more effective in reducing double taxation is this case and could incentivise a MNE group to headquarter in South Africa based on the reduced cost of providing South African-sourced services to Mozambique.

Calculations are provided in Appendix 1.4: Calculation of taxation on South African-sourced services provided to Mozambique.

6.4.5. South African-sourced services provided to Nigeria

There is currently a DTA in force between South Africa and Nigeria. Nigeria levies a 10% withholding tax on the gross amount of services fees paid to non-residents. There is no Article in the DTA that deals specifically with technical and management fees. Article 7 of the DTA provides that all profits of an enterprise of South Africa shall be taxable only in South Africa unless the enterprise carries on business in Nigeria through a permanent establishment situated therein. In accordance with the DTA, a South African headquarter company providing South African-sourced services to an associated company of an MNE group should be taxed in South Africa only.

NIGERIA		**Low Margin Services ZAR**		**High Margin Services ZAR**
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		1 000 000		1 000 000
Cost of South African normal tax with Section 6*quat* (1C) deduction - DTA not adhered to		81 553		560 000
Cost of South African normal tax with Section 6*quin* rebate - DTA not adhered to		-		-
Cost of South African normal tax if the DTA in force is adhered to		81 553		560 000
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction - DTA not adhered to	371.33%	1 081 553	78.00%	1 560 000
Total cost of taxes with section 6*quin* rebate - DTA not adhered to	343.33%	1 000 000	50.00%	1 000 000
Total cost of taxes if headquarter company relocated to a tax haven	343.33%	1 000 000	50.00%	1 000 000
Total cost of taxes if the DTA in force is adhered to	28.00%	81 553	28.00%	560 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin* when the DTA in force is not adhered to		81 553		560 000
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 9: Services to Namibia: summary of tax burden

In the analysis above, when applying section 6*quin* over section 6*quat*(1C) for low margin services there is a R81 553 tax saving for the headquarter company. When applying section 6*quin* over section 6*quat*(1C) for the high margin services there is a R560 000 tax saving for the headquarter company. If the tax authorities of Nigeria do not adhere to the DTA, the withholding tax levied by the tax authorities of Nigeria are levied on the gross amount of the services fees and so the effective tax rates are high on the services provided by the headquarter to the associated company in Nigeria of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate would be 343.33% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Nigeria. The effective tax rate would increase to 343.33% if the section 6*quin* rebate is not available for use. On the high margin services provided by the headquarter company, the effective tax rate would be 50% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Nigeria. The effective tax rate would increase to 78% if the section 6*quin* rebate is not available for use. If the tax authorities adhered to the DTA in force between South Africa and Nigeria, no withholding tax would be levied on the South African-sourced services provided by the headquarter company in South Africa. The services provided would be included in gross income for South African normal tax purposes and the effective tax rate would be 28%.

If the section 6*quin* rebate were to remain effective, SARS would forfeit R81 533 of income tax on the low margin services and would forfeit R560 000 of income tax on the low margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Nigeria benefits with the application of section 6*quin* on low margin services and high margin services over the application of section 6*quat*(1C) if the tax authorities in Nigeria withhold tax on the services incorrectly. Section 6*quin* is more effective in reducing double taxation is this case and could incentivise a MNE group to headquarter in South Africa based on the reduced cost of providing South African-sourced services to Nigeria.

Calculations are provided in Appendix 1.5: Calculation of taxation on South African-sourced services provided to Nigeria.

6.4.6. South African-sourced services provided to Tanzania

There is currently a DTA in force between South Africa and Tanzania. Tanzania levies a 15% withholding tax on the gross amount of services fees paid to non-residents. There is no Article in the DTA that deals specifically with technical and management fees. Article 7 of the DTA provides that all profits of an enterprise of South Africa shall be taxable only in South Africa unless the enterprise carries on business in Tanzania through a permanent establishment situated therein. In accordance with the DTA, a South African headquarter company providing South African-sourced services to an associated company of an MNE group should be taxed in South Africa only.

TANZANIA		**Low Margin Services ZAR**		**High Margin Services ZAR**
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		1 500 000		1 500 000
Cost of South African normal tax with Section 6*quat* (1C) deduction - DTA not adhered to		81 553		560 000
Cost of South African normal tax with Section 6*quin* rebate - DTA not adhered to		-		-
Cost of South African normal tax if the DTA in force is adhered to		81 553		560 000
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction - DTA not adhered to	543.00%	1 581 553	103.00%	2 060 000
Total cost of taxes with section 6*quin* rebate - DTA not adhered to	515.00%	1 500 000	75.00%	1 500 000
Total cost of taxes if headquarter company relocated to a tax haven	515.00%	1 500 000	75.00%	1 500 000
Total cost of taxes if the DTA in force is adhered to	28.00%	81 553	28.00%	560 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin* when the DTA in force is not adhered to		81 553		560 000
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 10: Services to Tanzania: summary of tax burden

In the analysis above, when applying section 6*quin* over section 6*quat*(1C) for low margin services there is a R81 553 tax saving for the headquarter company. When applying section 6*quin* over section 6*quat*(1C) for the high margin services there is a R560 000 tax saving for the headquarter company. If the tax authorities of Tanzania do not adhere to the DTA, the withholding tax levied by the tax authorities of Tanzania are levied on the gross amount of the services fees and so the effective tax rates are high on the services provided by the headquarter to the associated company in Tanzania of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate would be 515% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Tanzania. The effective tax rate would increase to 543% if the section 6*quin* rebate is not available for use. On the high margin services provided by the headquarter company, the effective tax rate would be 75% if the section 6*quin* rebate is utilised. The 6*quat* deduction would not be available to the headquarter company as there is a right of recovery from the tax authorities of Tanzania. The effective tax rate would increase to 103% if the section 6*quin* rebate is not available for use. If the tax authorities adhered to the DTA in force between South Africa and Tanzania, no withholding tax would be levied on the South African-sourced services provided by the headquarter company in South Africa. The services provided would be included in gross income for South African normal tax purposes and the effective tax rate would be 28%.

If the section 6*quin* rebate were to remain effective, SARS would forfeit R81 533 of income tax on the low margin services and would forfeit R560 000 of income tax on the low margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Tanzania benefits with the application of section 6*quin* on low margin services and high margin services over the application of section 6*quat*(1C) if the tax authorities in

Tanzania withhold tax on the services incorrectly. Section 6*quin* is more effective in reducing double taxation is this case and could incentivise a MNE group to headquarter in South Africa based on the reduced cost of providing South African-sourced services to Tanzania.

Calculations are provided in Appendix 1.6: Calculation of taxation on South African-sourced services provided to Tanzania.

6.4.7. South African-sourced services provided to Zambia

There is currently a DTA in force between South Africa and Zambia. Zambia levies a 20% withholding tax on the gross amount of services fees paid to non-residents. There is no Article in the DTA that deals specifically with technical and management fees. Article II of the DTA provides that income from management charges is not included in the meaning of "industrial or commercial profits" and consequently is not dealt with in the DTA. A South African headquarter company providing South African-sourced services to an associated company of an MNE group can be taxed in South Africa and Zambia.

ZAMBIA		**Low Margin Services ZAR**		**High Margin Services ZAR**
Cost of Taxes to South African Taxpayer				
Cost of withholding tax in foreign country on South African-sourced income		2 000 000		2 000 000
Cost of South African normal tax with Section 6*quat* (1C) deduction		-		-
Cost of South African normal tax with Section 6*quin* rebate		-		-
	Effective tax rate		**Effective tax rate**	
Total cost of taxes with section 6*quat* (1C) deduction	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes with section 6*quin* rebate	686.67%	2 000 000	100.00%	2 000 000
Total cost of taxes if headquarter company relocated to a tax haven	686.67%	2 000 000	100.00%	2 000 000
Cost of Taxes to the South African Fiscus				
Taxes not available to SARS due to section 6*quin*		-		-
Taxes not available to SARS if headquarter company is relocated to another jurisdiction (employees' tax)		2 106 796		1 736 000

Table 11: Services to Zambia: summary of tax burden

In the analysis above, there is no tax benefit in applying section 6*quin* over section 6*quat*(1C) for the low margin services and there is no tax benefit in applying section 6*quin* over section 6*quat*(1C) for the high margin services. Due to the withholding tax levied by the tax authorities of Zambia on the gross amount of the services fees, the effective tax rates are high on the services provided by the headquarter to the associated company in Zambia of the MNE group. On the low margin services provided by the headquarter company, the effective tax rate is 686.67% irrespective of the use of the section 6*quat*(1C) deduction or the section 6*quin* rebate. On the high margin services provided by the headquarter company, the effective tax rate is 686.67% irrespective of the use of the section 6*quat*(1C) deduction or the section 6*quin* rebate.

If the section 6*quin* rebate were to remain effective, SARS would not forfeit any income tax on the low margin services and on the high margin services. If the MNE group relocated the headquarter company to another jurisdiction, SARS would potentially forfeit an estimated R2 106 796 of employees' tax related to the low margin services provided and R1 736 000 of employees' tax related to the high margin services.

A South African headquarter company providing South African-sourced services to Zambia does not benefit with the application of section 6*quin* on the low margin services and high margin services over the application of section 6*quat*(1C).

Detailed calculations are provided in Appendix 1.7: Calculation of taxation on South African-sourced services provided to Zambia.

6.5. Conclusion

Section 6*quin* of the Income Tax Act was implemented by the National Treasury to provide effective relief to the South African taxpayer from double taxation on South African-sourced service fees charged to other countries, and in particular, other African countries. It is submitted that the relief from double taxation provided by section 6*quin* would encourage MNE groups to headquarter in South Africa. The results of the analysis in this chapter provide that section 6*quin* effectively reduces the effects of double taxation on South African-sourced services provided to other African countries compared to other double tax relief mechanisms available to the South African taxpayer.

The National Treasury proposed that the section 6*quin* rebate be withdrawn, explaining that the foreign tax rebate indirectly subsidises countries that do not comply with the tax treaties. The results of the analysis indicate that there is potentially less income tax collected by SARS, especially on high margin services provided due to the reduction in South African income tax with the application of section 6*quin*. The loss to the fiscus due to the use of section 6*quin* is, however, noticeably less than if the headquarter company had to relocate to a low tax jurisdiction to reduce the cost of providing services into Africa. This is due to employees' tax which will not be levied in South Africa if the headquarter company is located outside of South Africa.

Chapter 7 – Conclusion

This research study sought to determine the impact of double taxation on South African-sourced services provided from South Africa to other African countries and whether section 6*quin* provides more effective relief from double taxation compared to other double tax relief mechanisms available to the South African taxpayer which will incentivise MNE groups to headquarter in South Africa.

When analysing withholding tax on services such as management, technical and consultancy services which typically a headquarter company would provide, most of the African countries levy a withholding tax on payments to non-residents for services, irrespective of where the service is provided. This increases the cost of providing services to African countries. European countries either do not levy withholding tax on services provided by non-residents or levy a withholding tax on services paid to non-residents where the service is rendered in the country of the payer. It appears that the OECD's view of source is that, internationally, the source of income is usually where the services are performed. Most African countries do not follow this approach and levy a withholding tax on services received by non-residents, irrespective of where the actual source of the service is. Without double tax relief, the tax levied on these transactions is high.

The South African taxpayer can obtain relief from double taxation with the utilisation of DTAs and, unilaterally, with the use of domestic legislation. The relief from double taxation varies with the utilisation of different DTAs between South Africa and other African countries for the South African taxpayer providing South African-sourced services. Unilateral relief from double taxation can be obtained with the use of either the section 6*quat* rebate, section 6*quat* deduction, or the section 6*quin* rebate.

Where African countries withhold tax on South African-sourced services incorrectly, the South African taxpayer can either approach the relevant foreign revenue authority to correct the tax withheld; apply for assistance of competent authorities through mutual agreement procedure in accordance with a DTA to correct the tax withheld; or obtain double taxation relief with the application of section 6*quin.* It is submitted that approaching the relevant foreign revenue authority may not achieve the required result of the correction of the tax withheld. It is submitted that applying for assistance of competent authorities through mutual agreement procedure in accordance with a DTA is a cumbersome process which may not achieve the required outcome of the correction of tax withheld.

The results of the case study analysis of the cost of double taxation indicates that section 6*quin* provides effective relief from double taxation. This is especially true on high margin South African-sourced services provided by a South African headquarter company to other African countries and in cases where African countries withhold taxes incorrectly on services received by them.

The results of the case study analysis indicate that there is potentially less income tax collected by SARS, especially on high margin services provided due to the reduction in South African income tax with the application of section 6*quin*. The loss to the fiscus due to the use of section 6*quin* is, however, noticeably less than if the headquarter company had to relocate to a low tax jurisdiction to reduce the cost of providing services into Africa. This is due to employees' tax which will not be levied in South Africa if the headquarter company is located outside of South Africa.

South Africa has a number of attributes which would encourage MNE groups to headquarter in South Africa but the cost of doing business with the rest of Africa is high due to withholding taxes levied by African countries on management, technical and consultancy fees. Countries with low tax rates attract MNE groups to headquarter in those countries as this effectively reduces the cost of doing business with the rest of Africa. The National Treasury introduced section 6*quin* of the Income Tax Act to provide effective relief to the South African taxpayer from double taxation on South African-sourced service fees charged to other countries and, in particular, other African countries.

The results indicate that section 6*quin* provides a feasible solution to reducing double taxation on South African-sourced services provided to other African countries which incentivises MNE groups to headquarter in South Africa. This is evident from the multinational mobile telecommunications company, MTN's warning to the South

African Treasury on removing the section 6*quin* foreign tax rebate. One of the main considerations for MTN to locate its centralised service centre in South Africa was the provision of the section 6*quin* foreign tax rebate and if the rebate is withdrawn, the centralised service centre would run at a loss which would mean that MTN would consider relocating the centralised service centre out of South Africa.[85]

[85] Ensor, L. (17 September 2015). 'MTN warns against removing African tax incentive', *Business Day*.

Appendix 1

Appendix 1.1: Calculation of taxation on South African-sourced services provided to Angola

ANGOLA				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	(291 262)		(650 000)	
Taxable income	-		1 350 000	
Taxation @ 28%	-	-	378 000	378 000
Angola				
Withholding tax of 6.5%	650 000	650 000	650 000	650 000
		650 000		1 028 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Angola				
Withholding tax of 6.5%	650 000	650 000	650 000	650 000
		650 000		650 000

Table 12: Services to Angola: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

Appendix 1.2: Calculation of taxation on South African-sourced services provided to Botswana

BOTSWANA				
Section 6*quat* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quat* rebate	(81 553)	-	(560 000)	-
Botswana				
Withholding tax of 15% reduced to 10% by DTA	1 000 000	1 000 000	1 000 000	1 000 000
		1 000 000		1 000 000

Table 13: Services to Botswana: the comparison of the tax burden subsequent to the use of s6quat

Appendix 1.3: Calculation of taxation on South African-sourced services provided to Kenya

KENYA				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	-		-	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553	81 553	560 000	560 000
Kenya				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 081 553		2 560 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Kenya				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 000 000		2 000 000

Table 14: Services to Kenya: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

Appendix 1.4: Calculation of taxation on South African-sourced services provided to Mozambique

MOZAMBIQUE				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	-		-	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553	81 553	560 000	560 000
Mozambique				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 081 553		2 560 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Mozambique				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 000 000		2 000 000

Table 15: Services to Mozambique: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

Appendix 1.5: Calculation of taxation on South African-sourced services provided to Nigeria

NIGERIA				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	-		-	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553	81 553	560 000	560 000
Nigeria				
Withholding tax at 10%	1 000 000	1 000 000	1 000 000	1 000 000
		1 081 553		1 560 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Nigeria				
Withholding tax at 10%	1 000 000	1 000 000	1 000 000	1 000 000
		1 000 000		1 000 000

Table 16: Services to Nigeria: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

Appendix 1.6: Calculation of taxation on South African-sourced services provided to Tanzania

TANZANIA				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	-		-	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553	81 553	560 000	560 000
Tanzania				
Withholding tax at 15%	1 500 000	1 500 000	1 500 000	1 500 000
		1 581 553		2 060 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Tanzania				
Withholding tax at 15%	1 500 000	1 500 000	1 500 000	1 500 000
		1 500 000		1 500 000

Table 17: Services to Tanzania: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

Appendix 1.7: Calculation of taxation on South African-sourced services provided to Zambia

ZAMBIA				
Section 6*quat* (1C) Deduction				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Deduction	(291 262)		(2 000 000)	
Taxable income	-		-	
Taxation @ 28%	-	-	-	-
Zambia				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 000 000		2 000 000
Section 6*quin* Rebate				
	Low Margin Services	**Taxes**	**High Margin Services**	**Taxes**
South Africa				
Services	10 000 000		10 000 000	
Expenses	(9 708 738)		(8 000 000)	
Taxable income	291 262		2 000 000	
Taxation @ 28%	81 553		560 000	
Section 6*quin* rebate	(81 553)	-	(560 000)	-
Zambia				
Withholding tax at 20%	2 000 000	2 000 000	2 000 000	2 000 000
		2 000 000		2 000 000

Table 18: Services to Zambia: the comparison of the tax burden subsequent to the use of s6quin and s6quat(1C)

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