

**A COMPARATIVE STUDY OF
DOUBLE TAX AGREEMENTS
IN A SOUTHERN AFRICAN CONTEXT**

by

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Submitted in fulfilment of the requirements for the degree

MAGISTER COMMERCII IN TAXATION

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

SUPERVISOR: Professor T.L. Steyn

Pretoria

June 2015

DECLARATION



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ACKNOWLEDGEMENTS

I would like to express my appreciation to

- John Waugh, my lecturer in tax in the early 1970's at the then University of Natal, for stimulating my interest in the subject of taxation;
- Professor Theuns Steyn, my supervisor, for his guidance and advice;
- PricewaterhouseCoopers, for their assistance in obtaining the survey data and for financial support for the research paper presented at the International Tax Research Symposium of the International Fiscal Association in Basel, Switzerland; and
- my wife Linda Krause, my family and friends, for their support and encouragement.

ABSTRACT

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This study analyses Double Tax Agreements concluded by South Africa with the Southern African Development Community countries to identify in what respects these agreements do not follow the Organisation for Economic Co-operation and Development's *Model Tax Convention on Income and on Capital*. The study illustrates, in the format of a scenario analysis, the possible financial effects that the identified differences may theoretically have on the net income (after income tax) of corporate taxpayers in South Africa, if South Africa is the resident state.

This explorative study used a survey as its research strategy. It employed a standard questionnaire to collect data for the tax years 2012 and 2013 from four participants, all being companies listed on the JSE, to test the scenario analysis that underpins this study.

The research indicates that there are financial effects for South African corporate taxpayers, as resident state taxpayers, if the expenditure ratio to gross amount received exceeds certain ratios where the source state withholds withholding tax and where double taxation is eliminated according to the ordinary credit method.

Key words:

Double tax agreement, double taxation, elimination of double taxation, model tax conventions, model tax treaties, withholding tax.

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LIST OF ACRONYMS AND ABBREVIATIONS

BRICS	Brazilia, Russia, India, China and South Africa
DRC	Democratic Republic of Congo
DTA(s)	Double tax agreement(s), also called a tax treaty
IBFD	International Bureau for Fiscal Documentation
IRC	Internal Revenue Commissioner
Income Tax Act	<i>South African Income Tax Act, Act 58 of 1962 as amended effective 1 March 2014</i>
MAP(s)	Mutual Agreement Procedure(s) in terms of DTA(s)
MTC	Model Tax Convention
OECD	Organisation for Economic Co-operation and Development
OECD Model	Organisation for Economic Co-operation and Development <i>Model Tax Convention on Income and on Capital (2010)</i>
OEEC	Organisation for European Economic Co-operation
South African Model	South African Model Agreement for Avoidance of Double Taxation
SADC	Southern African Development Community
SADC Model	Southern African Development Community Agreement for the avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income (2013)
SARS	South African Revenue Service
UN	United Nations
UN Model	<i>United Nations Model Double Taxation Convention between Developed and Developing Countries (2011)</i>
WHT	Withholding Tax

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND

The term “international tax” is frequently used in taxation literature to describe the tax implications of international trade and transactions. However, the term “international tax” is a misnomer, because there is no international tax law (Olivier & Honiball, 2011:1).

The right to tax is part of a State’s sovereign powers. Different countries’ tax laws may be similar in many respects, but may also vary in several important aspects. These differences often lead to double taxation or to non-taxation of an entity operating in more than one country (Olivier & Honiball, 2011:1). Double tax agreements (DTAs), also referred to as tax treaties, are the instruments used internationally to regulate the taxing rights between competing countries (Olivier & Honiball, 2011:6).

The League of Nations¹ commenced work on double taxation as far back as 1921, and this led to the publishing of the first Model Bilateral Convention in 1928, followed by the Model Conventions of Mexico (1943) and London (1946) (OECD,² 2010:7). The first recommendations concerning double taxation were adopted by the Organisation for European Economic Co-operation (OEEC) on 25 February 1955 (OECD, 2010:7). As a result, at the time 70 bilateral general conventions were entered into between countries which are now all members of the Organisation for Economic Co-operation and Development (OECD) (OECD, 2010:7). The Fiscal Committee of the OECD commenced work on a draft convention in 1956 and prepared four interim reports between 1958 and

¹ The League of Nations was a general association of nations designed to create mutual guarantees of political independence and the territorial integrity of states. The Covenant establishing the League of Nations entered into force on 10 January 1920. The League of Nations transferred its assets to the United Nations on 18 April 1946 (Essential Facts about the League of Nations, 1939:11-29)

² The OECD is a forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD members are the following (in alphabetical order): Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom (UK) and the United States of America (USA). There are also a number of countries, such as the Democratic Republic of Congo and South Africa, that hold observer status.(OECD, 2010:427)

1961, before the *Draft Double Taxation Convention on Income and Capital* was published by the OECD in Paris in 1963 (OECD, 2010:8). This was followed by extensive study and revision, culminating in the publication of the *Model Double Tax Convention on Income and on Capital* in Paris in 1977 (OECD, 2010:8). The OECD maintains the *Model Tax Convention on Income and on Capital* (OECD Model) to provide guidance to countries that are negotiating DTAs (Olivier & Honiball, 2011:269). The OECD Model has been used as a basic document of reference between Member and non-Member countries and even between non-Member countries (OECD, 2010:10).

There are several model tax conventions other than that of the OECD, for instance, the *United Nations Model Double Taxation Convention between Developed and Developing Countries* (UN Model) developed by the United Nations (UN, 2011:vi), and the *Southern African Development Community (SADC) Agreement for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (SADC Model) (Olivier & Honiball, 2011:272). However, the UN Model and the SADC Model are not as widely used as the basis for negotiating DTAs as the OECD Model is (Olivier & Honiball, 2011:271). A number of Southern African models have also been developed or are in the process of being developed: *the East African Community Income Tax Treaty*, *the African Tax Administration Forum's Model Tax Convention* and *the Common Market for Eastern and Southern Africa's draft Model Tax Convention* (cited in Daurer, 2014:118-121).

1.2 RATIONALE FOR THE STUDY

The OECD Model is a widely accepted model used as an underpinning for DTAs worldwide, including in countries that are not members of the OECD (Olivier & Honiball, 2011:271), for instance, South Africa and the Democratic Republic of Congo (DRC). OECD-based tax treaties encourage large-scale international trade and investment, reassuring investors that they will not be subjected to double taxation (Heady, 2002:12). However, Heady (2002:12) argues that the OECD Model places too much emphasis on residence-based taxation, as opposed to source-based taxation. This may be prejudicial to developing countries in cases where the developing country is the source country. Daurer (2014:303) also advocates the development of a more radical source-based tax model to oppose the OECD Model.

Where countries do not use the OECD Model, it may be detrimental to resident states' corporate taxpayers, because DTAs that do not follow the OECD Model mostly provide more extensive taxing rights to the source state than the OECD Model allows. The additional taxing rights allowed to the source state often take the form of a withholding tax on the gross amount, and where the elimination of double taxation in the resident state is not by the full credit method, as opposed to the ordinary credit method;³ the elimination of double taxation may not be full and complete. This may result in the resident state's corporate taxpayer suffering residual double taxation.

This problem is also found in South Africa, which uses its own model (Olivier & Honiball, 2011:272) as a basis for negotiating DTAs, particularly DTAs with member countries of the SADC.⁴ Although the South African Model follows a combination of OECD/UN/SADC provisions (Van der Merwe, 2014), there are differences that may have a negative impact on corporate taxpayers in South Africa. This problem may be exacerbated by the possibility that a number of articles in the DTAs between South Africa and SADC member countries may deviate from the South African Model, even where an article in the South African Model is similar to the one in the OECD Model. The SADC published a Draft Model Tax Convention in 2001; it is likely that when the SADC Draft Model is ratified by all SADC countries this convention will be used by member states of the SADC as the basis for their DTA negotiations (Olivier & Honiball, 2011:272).

The various model tax conventions, "particularly the UN Model and the OECD Model, have a profound influence on international treaty practice, and have significant common provisions" (UN, 2011:vi). The similarities between the two leading models, the UN Model and the OECD Model, reflect the importance of achieving consistency where possible. The areas of divergence focus on differences in approach in country practice. The differences relate mainly to the question of how far one country or the other should forego taxing rights which would be available under domestic law in order to avoid double taxation and to encourage investment: "The United Nations Model Tax Convention generally favours

³ The ordinary credit method and the full credit method for the elimination of double taxation are discussed in Chapter 2 in this dissertation.

⁴ The member states of the SADC are the following (in alphabetical order): Angola, Botswana, the DRC, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. The SADC Model was not ratified by all SADC countries at the time of this study.

retention of greater so called ‘source country’ taxing rights under a treaty ... as compared to those of the ‘residence country’ of the investor” (UN, 2011:vi).

Several studies on the phenomenon of international tax focus on DTAs – e.g. a study by Blonigen and Davies (2004) investigates the effects of bilateral tax treaties on US FDI activity. Braun and Fuentes (2014) undertook a legal and economic analysis of Austria’s double tax treaty network with developing countries. A study by Daurer (2014) examines the role and adequacy of the UN Model to serve the needs of developing countries.

In the South African tax literature, the topic of DTAs is also a popular topic for investigation. For instance, Bland (2013) focuses on the use of and variations from the UN Model by SADC countries to determine the extent of the application of the UN Model by SADC countries. Bland (2013) focuses on all the DTAs concluded between SADC countries after 1980, and also analyses differences between the OECD Model and the UN Model. Van den Berg (2011) conducted a critical analysis of the DTAs between South Africa, Mauritius and China, comparing the results and pointing out deficiencies in the DTA between South Africa and China, compared to the DTA between China and Mauritius. Van den Berg’s (2011) focus is limited to the DTAs between South Africa, Mauritius and China, but it is useful in that it proposes a theoretical construct for the comparison of DTAs. A study by Johannes (2014) focuses on the interpretation of South Africa’s DTAs under international law. The main objective of a study by Costa & Stack (2014) was to investigate the legal status of DTAs and the relationship between different DTAs, referring to provisions of the *South African Income Tax Act, Act 58 of 1962*, (South Africa, 1962) provisions in the *Constitution of the Republic of South Africa, Act 108 of 96* (cited in Costa & Stack 2014). and national and international rules for the interpretation of statutes.

Existing studies related to DTAs in developing countries focus mainly on the legal interpretation of DTAs, for instance, the studies by Johannes (2014). Other studies, for example, that by Bland (2013), do investigate the difference between DTAs in an African context. Van den Berg (2014) also did a comparative study, but focuses only on selected South African DTAs. These studies tend to focus on the effects of DTAs on the states involved in the agreement, but do not investigate these effects specifically from the perspective of South African corporate taxpayers. Steyn (2012:8), referring to Stamp

(1921:201), argues that taxation questions must be considered not only from the perspective of the government, but also, and equally importantly, from the perspectives of taxpayers. This argument is in line with that of Brennan and Buchanan (1980:225), who emphasise the need to introduce tax policies that also take taxpayers into account. Hence, there is a need for a study that explores the phenomenon of model tax conventions and DTAs from the perspective of corporate taxpayers.

1.3 RESEARCH OBJECTIVES

The main objective of this study is to explore the effects that differences between articles included in DTAs between South Africa and other member countries of SADC and the corresponding articles in the OECD Model may have on South African corporate taxpayers.

This main research objective is supported by the following secondary objectives:

- to analyse selected DTAs between South Africa and other SADC member countries critically, and to compare these DTAs with corresponding articles from the UN Model, the SADC Model and the South African Model (the main purpose of this analysis is to identify possible differences between articles in these DTAs and models that may affect corporate taxpayers in South Africa);
- to analyse selected DTAs between South Africa and other SADC member countries critically, and to compare these DTAs with corresponding articles in the OECD Model (the main purpose of this analysis is to identify possible differences between articles in these DTAs and the corresponding articles in the OECD Model that may affect corporate taxpayers in South Africa);
- to clarify and illustrate the theoretical financial effect that identified differences may have, in the form of residual double tax exposure, on corporate taxpayers in South Africa (the purpose is to structure and clarify the theoretical framework underpinning the empirical phase of the study);
- to explore empirically the theoretical financial effects of the identified differences, in the form of residual double tax exposure, on South African corporate taxpayers; and
- to reach a conclusion on the results of the study and make suggestions for future research.

1.4 IMPORTANCE OF THE STUDY

To the knowledge of the researcher this is the first extensive comparative study of the South African Model, the SADC Model, the UN Model and DTAs between South Africa and other SADC countries, against the OECD Model (OECD, 2010). This is also the first study to explore the financial effects of differences between the DTAs South Africa and other SADC countries and the OECD Model on South African corporate taxpayers, based on the corporate taxpayers' perspectives.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

The main objective of this study is to investigate the differences between articles in DTAs between South Africa and other SADC member countries and corresponding articles in the OECD Model, and the effect these differences may have on the net income after income tax of corporate taxpayers in South Africa. Important elements of the scope of the study are explained below:

- This study does not consider DTAs between South Africa and other SADC countries that pre-date the 1977 OECD Model Tax Convention. South Africa concluded DTAs after 1977 with the following SADC member countries: Botswana (2004), the DRC (2012), Lesotho (1997), Mauritius (1997), Mozambique (2009), Namibia (1999), Seychelles (2003), Swaziland (2005a) and Tanzania (2007). Therefore the DTAs that South Africa concluded before 1977 with Malawi (1971), Zambia (1958 and 1980) and Zimbabwe (1965) are excluded from this study.
- This study is limited to the OECD Model, the UN Model, the SADC Model and the South African Model. It does not consider the effect that any other model tax convention may have on corporate taxpayers in South Africa.
- The OECD Model (2010) is the basis of the study, because the study was in an advanced stage when the OECD (2014) *Update to the OECD model tax convention* was published on 1 September 2014.
- This study considers South Africa's domestic tax legislation only to the extent that it has a bearing on DTAs and relief from double taxation.
- This study does not differentiate between transactions with related and unrelated parties, because it assumes that transfer pricing legislation, particularly South African

transfer pricing legislation, should result in the application of comparable unrelated party pricing principles to related party transactions. The international focus on base erosion and profit shifting is also likely to result in comparable unrelated party pricing principles' applying to related party transactions.

- The study is an analysis of deviations and not a study of the fundamental reasons underlying the deviations.
- The study does not consider the articles in DTAs dealing with dividends, because dividends are a distribution to shareholders and not an item making-up net income after tax. The focus of the study is the effect on net income after tax for the South African corporate taxpayer.

1.6 RESEARCH DESIGN AND METHODS

The research is exploratory in nature. It is therefore hoped that it will encourage further research and debate on the topic. The study does not use statistical hypothesis testing; it is qualitative, with an interpretive orientation. The purpose of the research is to understand the phenomenon in depth, as described by Henning, Van Rensburg and Smit (2004:3), rather than to understand the relationship between particular variables (Henning *et al.*, 2004:3).

This study compares the DTAs concluded by South Africa with other SADC countries against the OECD Model, the prevailing model convention (Daurer, 2014:1), identifies deviations from the OECD Model, and assesses the financial effect, in the form residual double taxation, to the South African corporate taxpayer resulting from these deviations from the OECD Model. The study also refers to the UN Model, the SADC Model and the South African Model. The OECD Model is one of the most widely used models for negotiating tax treaties amongst both developed and developing countries (Bland, 2013:iii).

This study commences with a review of the relevant literature to establish and clarify the theoretical underpinnings of the study. This is followed by a critical analysis of articles in the South African Model, the SADC Model, and selected DTAs in order to identify differences between these articles and corresponding articles in the OECD and UN

Models. The theoretical phase of the study is concluded with a scenario analysis that clarifies the theoretical framework adopted in the empirical phase of the study.

The empirical phase of this study explores the potential financial effects of the identified differences, in the form of residual double tax exposure, on South African corporate taxpayers, using a multiple data approach. The data was collected by means of a survey in the format of a standard questionnaire that consisted mainly of closed-ended questions. The primary data collected present a snapshot of the participants' situation at a particular point in time, making the study a cross-sectional study, as described by Saunders, Lewis and Thornhill (2009:155).

The research concentrated on sensitive financial information from the participants. Therefore, informed consent was obtained from each of the research participants. The informed consent forms explain the confidentiality with which the information is treated and the anonymity of each participant in detail. The approval of all the relevant parties was obtained where necessary, and the approval of the Research Ethics Committee of the Faculty of Economic and Management Sciences at the University of Pretoria was obtained before the fieldwork commenced.

1.7 STRUCTURE OF THE DISSERTATION

The main outcomes of the study are presented in the format of a dissertation. The structure of the dissertation is explained and summarised below.

1.7.1 Chapter 1: Introduction

Chapter 1 provides an introduction to and background on the study. It also sets out the research objectives of the study. The rationale for the study is given and the scope of the study is clarified. The research method is briefly explained, and an overview of the chapters is provided.

1.7.2 Chapter 2: Literature review

Chapter 2 presents an overview of the topic as an area of research in the relevant literature. This chapter also clarifies the theoretical underpinnings of this study, consisting of the OECD Model, the UN Model, the SADC Model, the South African Model, and DTAs between South Africa and other SADC member countries.

1.7.3 Chapter 3: Critical comparison

Chapter 3 focuses on differences between articles in the UN Model, the SADC Model, the South African Model, the selected DTAs and the articles in the OECD Model. It also illustrates the effects that these identified differences may theoretically have on corporate taxpayers' net income after income tax in South Africa

1.7.4 Chapter 4: Research design and methodology

Chapter 4 explains the research design and methodology.

1.7.5 Chapter 5: Data analysis

Chapter 5 explains the method used in analysing the data from the multiple survey and presents the results of the analysis.

1.7.6 Chapter 6: Summary and conclusions

Chapter 6 brings the study to conclusion. The chapter summarises the findings and conclusions from the other chapters, explains the contribution and limitations of the study and proposes a number of ideas for future research.

CHAPTER 2: LITERATURE REVIEW

2.1 INTRODUCTION

The purpose of this study is to explore differences between articles included in DTAs between South Africa and other SADC member countries and corresponding articles in the OECD Model, and the effects that these differences may have on corporate taxpayers' net income after income tax in South Africa.

The objective of the chapter is to clarify the theoretical basis from which differences between the OECD Model and the DTAs between South Africa and other SADC member countries are identified in this study. The chapter provides an overview of the literature, an orientation of the OECD Model, the UN Model, the SADC Model and the South African Model, clarifying the extent to which the models are used as a theoretical basis in the study. The chapter concludes with a summary.

The key model tax conventions used in this study are discussed in this chapter. The main focus is the OECD Model, to which the other models are compared. These conventions are directly relevant to this study, read in conjunction with studies that have a direct bearing on the model conventions.

The chapter places the SADC Model and the South African model in their international context and lists a number of studies, indicating their relevance to the current study. It then gives an overview of the OECD Model, the UN model, the SADC Model and the South African Model.

A number of relevant studies and South African tax legislation are discussed in more detail in Annexure 1.

2.2 THE SADC MODEL AND THE SOUTH AFRICAN MODEL IN CONTEXT

SADC published its Draft Model in 2001. It is likely that once the SADC Draft Model has been ratified by all SADC countries this model will be used by all SADC member states as a basis for their DTA negotiations (Olivier & Honiball, 2011:272). The current SADC Model (SADC 2013) is the *Southern African Development Community Agreement for the avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income* (2013)

The South African Model is the basis for DTAs negotiated by South Africa. It follows a combination of the OECD's, UN's, and SADC's provisions (Van der Merwe, 2014).

There are a number of studies that investigate a variety of phenomena related to model tax conventions and DTAs, for instance, the studies by Lang, Pistone, Schuch, Staringer (2014), Mazansky (2009) and Schwarz (2011). In the Southern African context, such studies are much more limited, especially ones that focus on DTAs between South Africa and other SADC countries. Recent studies with this focus are those by Johannes (2014), Bland (2013) and Van den Berg (2014).

Bland (2013) focuses on the use of, and variations from, the UN Model by SADC countries to determine the extent of the application of the UN Model by SADC countries. Bland's study is limited to DTAs concluded among SADC countries since 1980. Bland (2013:iii) argues that the OECD Model is one of the most widely used models for negotiating tax treaties amongst both developed and developing countries. Van den Berg (2014) also follows a comparative approach, but focuses only on the DTAs that South Africa has concluded with Mauritius and China. Johannes (2014) mainly focuses on the legal interpretation of DTAs.

Most of the existing studies focus on the effects of DTAs on the countries involved in the agreements, but do not investigate these effects from the perspectives of South African corporate taxpayers.

2.3 OECD MODEL TAX CONVENTION ON INCOME AND ON CAPITAL

This section provides some background as a brief introduction to the *OECD Model Tax Convention on Income and on Capital* (OECD Model), in order to illustrate the status of this model as the theoretical underpinning to other model tax conventions and DTAs. The section then considers important elements of the OECD Model, looking at articles included in the model, to explain and to limit the extent to which this study uses the OECD Model as a theoretical basis. The section concludes with a summary which clarifies the theoretical basis for the remainder of this study, which identifies differences between this model and other relevant models and DTAs.

The OECD Model (2010) is used as basis in this study because the OECD (2014) *Update to the OECD model tax convention* was published on 1 September 2014 when this study was in an advanced stage. The OECD (2014) update covers ; application of Article 17, changes to Article 26 and its commentary, revised proposals on beneficial ownership, revised discussion draft emission permits and credits, tax treaty treatment of termination payments, and positions and reservations by Members and non-Members (OECD, 2014:1). The Articles covered by the update are not the subject of this study.

2.3.1 Background

It is important to understand the OECD Model (OECD, 2010) as a point of departure. The model started as a Draft Double Taxation Convention in 1963, and thus formed a basis for other model tax conventions, notably the UN Model (OECD, 2010:10). The OECD Model was used as the basis in the original drafting and revision of the UN Model. The OECD Model has also been used as a basic document of reference in negotiations between OECD Member countries and non-OECD Member countries and in the work of other worldwide and regional organisations (OECD, 2010:10).

The initial work on model tax conventions began with the League of Nations⁵ as far back as 1921, resulting in the first model bilateral convention in 1928, followed by the Model Tax

⁵ The League of Nations (1919–1946) born from the desire of the victors of the First World War to avoid such a devastating war in future.

Conventions adopted in Mexico in 1943 and in London in 1946 respectively. The League of Nations was followed by the OEEC,⁶ and its first recommendation concerning double taxation was adopted on 25 February 1955 (OECD, 2010:7). Increasing economic activity after the Second World War between OEEC member countries revealed the increasing importance of preventing international double taxation. It was recognised that there was a need to extend the network of bilateral tax conventions to all members of the OEEC, to harmonise these conventions and to reach agreement on a common interpretation (OECD, 2010:8).

The Fiscal Committee of the OECD commenced work in 1956 on a draft convention which would resolve double taxation problems between OECD member countries. The Fiscal Committee prepared four interim reports between 1958 and 1961 before submitting its final report entitled *Draft Double Taxation Convention on Income and Capital* in 1963 (OECD, 2010:8). The Fiscal Committee, and after 1971, the Committee on Fiscal Affairs, revised the 1963 Draft Convention and the Commentaries. This revision resulted in 1977 in the publication of a new Model Convention and Commentaries entitled *Model Double Taxation Convention on Income and Capital*, released by the OECD in Paris in 1977 (OECD, 2010:8). Revision is an on-going process, and the Commentaries are updated in between updates of the OECD Model. The most recent complete OECD Model used in this study is the 2010 *Model Tax Convention on Income and on Capital* (OECD, 2010).⁷

The OECD does not apply only to bilateral agreements. Multilateral conventions also occur. A practical example is the *Nordic Convention on Income and Capital* (cited in OECD, 2010:16) concluded between Denmark, Finland, Iceland, Norway and Sweden, with the Faroe Islands joining later. It is a multilateral convention between a group of OECD members that follows the provisions of the OECD Model closely (OECD, 2010:16). This raises the possibility of a multilateral convention in the Southern African context between SADC countries. The main difficulty with multilateral conventions (as opposed to bilateral conventions) is that it is more difficult for consensus has to be reached between all the countries in the grouping.

⁶ The OEEC was brought into existence by 18 participants on 16 April 1948, but declined after 1952.

⁷ In the current study, the 2010 version was current. The 2014 version has since been released, but the differences are so minor that the references to the 2010 version were retained.

The standing of the OECD Model as the international standard for tax conventions is demonstrated by the fact that it is followed not only by the 30 OECD Member countries, but also by a further 30 non-OECD Member countries with observer status (OECD, 2010:10).

The OECD Model consists of seven chapters dealing with a vast number of different aspects, referred to and addressed in the OECD Model under various articles. In addition, the Model includes Commentaries from member countries and non-member countries, previous reports related to the Model, and Appendices on specific issues. Each of these is briefly discussed below in relation to this study, starting with the Commentaries from member countries, followed by the Commentaries from non-member countries, the articles in the OECD Model, previous reports and finally the Appendices on specific issues.

2.3.2 Commentaries from Member countries

The OECD Model explains that it attempts, where possible, to specify a single rule for each situation. However, in some respects, a “degree of flexibility” (OECD, 2010:13) has been left to facilitate efficient implementation of the OECD Model. Members therefore retain some flexibility, for instance, in setting tax rates at source on dividends and interest, in their choice of how to eliminate double taxation, and the allocation of profits to permanent establishments. In some cases, additional or alternative provisions are covered in the Commentaries (OECD, 2010:13).

There is a Commentary on each article in the OECD Model to illustrate or interpret the provisions of the article. The Commentaries have been drafted and agreed on by experts appointed to the Committee on Fiscal Affairs by the governments of Member and Observer countries. Tax administrations use the Commentaries in interpreting and implementing bilateral treaties. Courts also use the Commentaries in reaching their decisions. The Commentaries are thus important in the development of international fiscal law (OECD, 2010:14).

OECD Member countries are in agreement on the aims and the main provisions of the OECD Model, but many have reservations on individual provisions. These reservations are

therefore recorded in the Commentaries on the articles. The Committee on Fiscal Affairs wants these reservations to be read against the background of the wide areas of agreement achieved by the OECD Model (OECD, 2010:14).

2.3.3 Non-member countries' positions

The Committee on Fiscal Affairs of the OECD decided in 1991 that, because the influence of the OECD Model had extended beyond the OECD Member countries, the ongoing process through which the OECD Model would be updated should be opened to benefit from the input of non-OECD Member countries too (OECD, 2010:427).

The positions of the 30 OECD Non-Member countries on the OECD Model are also reflected in the Commentaries to the OECD Model (OECD, 2010:427-463). These positions indicate that the countries are generally in agreement with the aims and the main provisions of the OECD Model, however, again, many have reservations on specific provisions, and their positions are recorded in the Commentaries on the articles. The current study reflects the positions of SADC countries, namely South Africa and the Democratic Republic of Congo, as Observer countries (OECD, 2010:427).

2.3.4 Articles in the OECD model

Each article in the OECD Model serves a different purpose. The articles can be classified into four categories (Holmes, 2007:85-86):

- articles dealing with the application of the Model;
- articles dealing with the distributive rules;
- articles dealing with tax avoidance and evasion; and
- articles dealing with various other matters.

Table 1, overleaf, provides a summarising overview of the classification of the OECD Model's articles.

Table 1: Classification of the OECD Model's articles

Category	Articles in the OECD Model
1. Application of the OECD Model.	<ul style="list-style-type: none"> • Article 1: Persons covered. • Article 2: Taxes covered. • Article 3: General definitions. • Article 4: Resident. • Article 5: Permanent establishment. • Article 30: Entry into force. • Article 31: Termination.
2. Distributive rules:	
2.1 Active income.	<ul style="list-style-type: none"> • Article 7: Business income • Article 8: Shipping, inland waterways transport and air transport. • Article 14: Independent personal services. • Article 15: Dependant personal services. • Article 16: Directors' fees. • Article 17: Artistes and sportsmen. • Article 19: Government services. • Article 20: Students.
2.2 Passive income.	<ul style="list-style-type: none"> • Article 6: Income from immovable property. • Article 10: Dividends. • Article 11: Interest. • Article 12: Royalties. • Article 13: Capital gains, together with Article 22: Capital. • Article 18: Pensions.
2.3 Other income.	<ul style="list-style-type: none"> • Article 21: Other income.
2.4 Elimination of double taxation.	<ul style="list-style-type: none"> • Article 23: Methods of eliminating double taxation.
3. Tax avoidance and evasion.	<ul style="list-style-type: none"> • Article 9: Associated persons.
4. Various others.	<ul style="list-style-type: none"> • Article 24: Non-discrimination. • Article 25: Mutual agreement procedure. • Article 26: Exchange of information. • Article 27: Assistance in collection of taxes. • Article 28: Members of diplomatic missions and consular posts. • Article 29: Territorial extension.

Source: Adapted from Holmes (2007:86-92)

The OECD Model's articles provide an *a priori* theoretical basis for identifying the differences between these Articles and the articles of other models and DTAs. However, it is recognised in the current study that there may be differences that originate from unique articles in these other models and DTAs that are not included in the OECD Model. Where

relevant, these differences are identified as “not in OECD Model”. This theoretical framework is used as a basis for a critical comparison between these models and DTAs, with the purpose of identifying differences between them that may affect the net income of corporate taxpayers in South Africa after income tax.

This study focus on the articles of the OECD Model that are classified under the category of distributive rules (referred to in the rest of the study as distributive articles) and the articles dealing with relief from double taxation. Although it is possible that the remaining articles may also affect a corporate taxpayer in South Africa, the scope of this explorative study is limited to the distributive rules. The distributive articles considered for this study are discussed below (in order of their appearance in the OECD Model).

2.3.4.1 Article 6: Income from immovable property

This article deals with income from immovable property, including income from agriculture or forestry (OECD, 2010:26). The principle applied is that the income from immovable property is subject to tax in the contracting state where the property is situated, in other words, the source state. Paragraph 2 excludes ships, boats and aircraft, which are not regarded as immovable property.

A significant point in paragraph 1 of the Commentary (OECD, 2010:128) is that although income from agriculture or forestry is regarded as income from immovable property, contracting states may agree in bilateral conventions to treat such income as business profits under Article 7. The reservations on the article, in paragraphs 5 to 12 (OECD, 2010:129), have been recorded by Finland, France, Spain, Canada, New Zealand, the United States, Australia and Mexico. These reservations mostly relate to income derived from immovable property through a third party, such as a company or a time share arrangement. New Zealand includes fishing and rights to natural resources under Article 6 (OECD, 2010:129), and Australia also includes rights to natural resources under this article (OECD, 2010:129).

The SADC countries have not recorded a position on this article.

2.3.4.2 Article 7: Business income

This article regulates business profits. The principle applied is that the profits of an enterprise of a contracting state are taxable only in that state, unless the enterprise carries on business in the other contracting state through a permanent establishment in the other state (OECD, 2010:26). In that case, the profits of the enterprise may be taxed in that other state, but only to the extent that the profits are attributable to that permanent establishment. Paragraph 4 of Article 7 contains an important provision: where profits include items of income which are dealt with in other articles of the convention, the provisions of the other articles are not affected by the provisions of Article 7 (OECD, 2010:27).

In paragraph 1 of the Commentary (OECD, 2010:130), it is pointed out that the taxation of business profits is in many respects a continuation of, and corollary to Article 5, the article on permanent establishments. If an enterprise has a permanent establishment in a contracting state, then Article 7 largely provides the ground rules for attributing profits to such a permanent establishment (OECD, 2010:131). Two OECD reports, *Attribution of Income to Permanent Establishments* 1993 (cited in OECD, 2010:131) and *Attribution of Profits to Permanent Establishment* 2008 (cited in OECD, 2010:131) are important amplifications of the Commentary. The Commentary in paragraph 1 (OECD, 2010:130) links Article 7 (Business profits) and paragraph 5 (OECD, 2010:131) links Article 9 (Transfer pricing). The Commentary refers to the OECD's (1995) report, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* for further guidance (cited in OECD, 2010:131). Belgium's observation that it considers the application of foreign control legislation contrary to the provisions of Article 7 should be noted (OECD, 2010:151). Korea and Portugal reserve the right to tax persons performing professional services for a period or periods exceeding 183 days in any twelve months in these countries, even if they do not have a permanent establishment available to them (OECD, 2010:152).

The SADC countries have not recorded any position on this article.

2.3.4.3 Article 8: Shipping, inland waterways transport and air transport

This article deals with shipping, inland waterways transport and air transport (for convenience, these are referred to as international traffic). In principle, the profits from these activities are taxed in the contracting state in which the place of effective management of the enterprise is situated (OECD, 2010:27). In terms of paragraph 12 of the Commentary (OECD, 2010:176), the article does not apply to a shipbuilding yard operated in one country by a shipping enterprise which has its place of effective management in another country. The provisions on permanent establishments contained in Article 5 should apply.

The Commentary in paragraphs 18 to 24 (OECD, 2010:178-179) deals with the position of enterprises not exclusively engaged in international traffic. The most noteworthy reservations are Australia's decision to tax profits from the carriage of passengers and cargo taken on board in any place in Australia for discharge in Australia (OECD, 2010:180), and Turkey's reservation of the right to apply the permanent establishment rule in exceptional cases (OECD, 2010:180).

South Africa has recorded a number of positions, reserving the right to include the leasing of containers, the leasing of ships or aircraft on a bare boat basis, and not to include inland waterways transportation in bilateral conventions (OECD, 2010:446).

2.3.4.4 Article 10: Dividends

Dividends fall outside the scope of the present study because they fall after net income before tax and are an item of income not subjected to full taxation in terms of the South African domestic tax laws. However, as it falls within the group of "distributive rules articles", it is discussed for the sake of completeness.

This article (OECD, 2010:28-29) regulates the taxing of dividends. Dividends paid by a company resident in a contracting state to a resident of the other contracting state may be taxed in the other contracting state. Paragraph 2 allows the contracting state in which the company paying the dividend is resident to tax the dividends, but limits the tax rate if the

beneficial owner of the dividend is a resident of the other contracting state (OECD, 2010:28).

Paragraph 3 defines the term “dividend” (OECD, 2010:28), and paragraph 4 deals with a situation where a resident of a contracting state carries on business through a permanent establishment in the other contracting state and the holding in respect of which the dividend is paid is effectively connected to the permanent establishment (OECD, 2010:28). In that case, the provisions contained in Article 7 regarding business profits apply. The term and concept “beneficial owner” is covered in paragraph 12 of the Commentary and is used in a broad sense, making the point that the state of source is not obliged to give up taxing rights over dividends merely because a dividend is received by a resident of the other state (OECD, 2010:187). The report from the Committee on Fiscal Affairs, *Double Taxation Conventions and the Use of Conduit Companies* (cited in OECD, 2010:188), concludes that a conduit company cannot normally be regarded as the beneficial owner of the dividend.

South Africa has recorded its positions on the tax rates and minimum shareholding (OECD, 2010:448).

2.3.4.5 Article 11: Interest

According to Article 11 of the OECD Model (OECD, 2010:29-30), interest arising in a contracting state and paid to a resident of the other contracting state is taxed in the other contracting state. The interest may be taxed in the contracting state in which it arises, however, if the beneficial owner of the interest is a resident of the other contracting state, but the tax is limited to 10% of the gross amount.

Paragraph 3 (OECD, 2010:29) defines the term “interest”. It excludes from the definition any penalty charges for late payment. Paragraph 4 (OECD, 2010:29) deals with the position where the interest arises in connection with a permanent establishment where the fall-back is Article 7 (Business profits). Paragraph 5 (OECD, 2010:29) contains a deeming provision as to where interest arises, and paragraph 6 (OECD, 2010:29-30) deals with the transfer pricing consequences of excessive interest because of a special relationship between the payer of the interest and the beneficial owner of the interest. The

Commentary on paragraph 4 (OECD, 2010:206) points out that some countries only allow interest paid to be deducted for the purpose of the payer's tax if the recipient of the interest also resides in the same state or is taxable in that state. Paragraph 6 of the Commentary (OECD, 2010:207) states that Article 11 regulates only interest arising in a contracting state and paid to a resident of the other contracting state. It does not apply to interest arising in a third state, or to interest arising in a contracting state attributable to a permanent establishment in that contracting state.

A very important point is made in paragraph 7.1 of the Commentary (OECD, 2010:207), where the beneficiary of the interest has borrowed to finance the operation which earns the interest, the profit realised by way of interest is reduced by interest payable on the borrowing while the tax charges in the source state are on the gross. The double taxation cannot be relieved by the resident state because less tax is charged on the net in the resident state than the tax charged on the gross by the source state.

No positions have been recorded by SADC countries.

2.3.4.6 Article 12: Royalties

Article 12 of the OECD Model contains the provisions relating to royalties (OECD, 2010:30). The principle is that royalties arising in a contracting state and beneficially owned by a resident of the other contracting state are taxable only in that other contracting state.

Paragraph 2 defines the term "royalties" as "payment of any kind as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design, plan, secret formula or process, or *for information concerning industrial commercial or scientific experience*" (OECD, 2010: 30; emphasis added). Paragraph 3 contains the fall-back provision to Article 7 (Business profits), where royalties are connected to a permanent establishment. Paragraph 4 regulates the transfer pricing position where the royalties are excessive, resulting from a special relationship between the parties. The Commentary in paragraph 2 (OECD, 2010:220) states that some countries only allow royalties paid to be deducted for the

purpose of the payer's tax if the recipient of the royalties also resides in the same state or is taxable in that state.

Paragraph 5 of the Commentary (OECD, 2010:221) indicates that Article 12 regulates only royalties arising in a contracting state and paid to a resident of the other contracting state. The regulation is not applicable to royalties arising in a third state or to royalties arising in a contracting state and that can be attributed to a permanent establishment in that contracting state. Paragraph 8.2 of the Commentary (OECD, 2010:222) states that where the payment relates to the transfer of full ownership in an element of property referred to in the definition of royalties, then the payment does not relate to the use of or the right to use and cannot represent a royalty.

An important distinction is made in paragraph 10.2 of the Commentary (OECD, 2010:224) between the payment for the right of use or the use of a design that already exists and the payment for a design that does not yet exist and still has to be developed. The payment for the right of use or the use of a design that exists is a royalty; the payment for a design that does not exist and has to be developed is a payment for services. Paragraph 11 (OECD, 2010:225) clarifies payments as a consideration for information concerning industrial, commercial or scientific experience, referring to the concept of "know-how". It refers to unpatented, undivulged information which has a practical application, if disclosing the information can have economic benefit. This definition refers to previous experience. Hence the article does not apply to new information obtained as a result of performing services at the request of the payer. Royalties differ from contracts for the provision of services using customary skills of a calling to execute work for another party.

The position taken by South Africa (OECD, 2010:450-452) is that it reserves the right to tax royalties at source, and to add a provision defining the source of royalties by analogy with the provisions dealing with interest. The Democratic Republic of Congo also retains the right to tax royalties at source (OECD, 2010:450-451).

2.3.4.7 Article 13: Capital gains

This article regulates the taxing of capital gains (OECD, 2010:30-31). The principle is that capital gains derived by a resident of a contracting state from the alienation of immovable property situated in the other contracting state may be taxed in that other contracting state.

Paragraph 2 (OECD, 2010:30-31) deals with the gains by a resident of a contracting state from the alienation of immovable property forming part of a permanent establishment in the other contracting state where the other contracting state has the right to tax the gains. The gains from alienation of ships or aircraft operated in international traffic and boats engaged in inland waterway transport are taxed in the contracting state in which the place of effective management is situated, according to paragraph 3 (OECD, 2010:31). Paragraph 4 deals with gains by a resident of a contracting state from alienation of shares which derive more than 50% of their value from immovable property in the other contracting state and which may be taxed in the other contracting state (OECD, 2010:31). In terms of paragraph 5, all other gains from alienation of property are taxable in the contracting state of which the alienator is a resident (OECD, 2010:31). The point is made in paragraph 3 of the Commentary (OECD, 2010:238) that it is in terms of the domestic laws of each contracting state that capital gains are taxed or not taxed. Article 13 does not give a contracting state the right to tax capital gains if it has not provided for doing so in domestic laws.

2.3.4.8 Article 14: Independent personal services

Personal services fall beyond the scope of this study, as they do not apply to corporate taxpayers. However, this provision falls within the group of “distributive rules articles”, so it is discussed for the sake of completeness.

This article dealing with independent personal services has been deleted and restores the provisions of Article 7, business profits.

The Commentary (OECD, 2010:250) provides details on the reason for deleting the article with reference to the report by the Committee on Fiscal Affairs of 27 January 2000 entitled *Issues Related to Article 14 of the OECD Model Tax Convention* (cited in OECD,

2010:250). The decision reflects the argument that no difference was intended between the concepts of permanent establishment in Article 7 and a fixed base as used in Article 14.

2.3.4.9 Article 15: Income from employment

Income from employment, fall beyond the scope of this study, as they do not apply to corporate taxpayers. However, this provision falls within the group of “distributive rules articles”, so it is discussed for the sake of completeness.

Salaries, wages and other forms of remuneration derived by a resident of a contracting state are taxed in that state unless the employment is in the other contracting state when the remuneration may be taxed in the other contracting state. However, paragraph 2 provides for certain exclusions: if the recipient is present in the other contracting state for less than 183 days in aggregate, the remuneration is paid by an employer who is not a resident of the other contracting state and “the remuneration is not borne by a permanent establishment” in the other contracting state (OECD, 2010:31). Paragraph 3 provides that remuneration from employment on “a ship or aircraft operated in international traffic” and “a boat engaged in inland waterways transport” may be taxed in the contracting state where the place of effective management of the enterprise is situated (OECD, 2010:31).

2.3.4.10 Article 16: Directors’ fees

Directors’ fees and similar payments derived by a resident of a contracting state as a member of a company board which is resident in the other contracting state may be taxed in the other contracting state (OECD, 2010:32).

The Commentary in paragraph 1 (OECD, 2010:269) makes the point that, because it might be difficult to ascertain where the services are performed, the article treats the services as performed in the state of residence of the company. The point is made in paragraph 2 (OECD, 2010:269) that a director of a company may perform other functions with the company as an employee, advisor or consultant, and that this article does not apply to remuneration in respect of those functions. Reservations on the article have been recorded by the United States, Belgium and Greece (OECD, 2010:270).

2.3.4.11 Article 17: Artistes and sportsmen

The taxation of artistes and sportsmen⁸ fall beyond the scope of this study, as the article is not applicable to corporate taxpayers. However, as the provision falls within the group of “distributive rules articles”, it is discussed for the sake of completeness.

Income derived by entertainers and sportspersons resident in a contracting state from personal activities in the other contracting state may be taxed in the other contracting state (OECD, 2010:32).

The Commentary (OECD, 2010:271) argues that the provision is an exception to the rules in Article 7 (Business profits), and Article 15 (Income from employment). Contracting states may limit the application of Article 17 to business activities and revert to the provisions of Article 15 in cases of performance in the course of employment. Paragraph 9 states that entertainers and sportspersons receive income in the form of royalties, sponsorship and advertising not directly linked to the performance, and that Article 12 would apply to royalties, and Article 17 to sponsorships and advertising (OECD, 2010:272). Observations to the Commentary have been recorded by Germany (OECD, 2010:275), and reservations on the article have been noted by Canada, Switzerland and the United States (OECD, 2010:275).

2.3.4.12 Article 18: Pensions

Pensions fall beyond the scope of this study, as the provision is not applicable to corporate taxpayers. However, as it falls within the group of “distributive rules articles”, the article is discussed for the sake of completeness.

This article states that pensions paid in respect of private employment to a resident of a contracting state in consideration for past employment are to be taxed only in that state (OECD, 2010:32).

South Africa retains the right to include annuities (OECD, 2010:456).

⁸ In the 2014 version, the wording has been changed to “Entertainers and sportspersons”

2.3.4.13 Article 19: Government service

Government service falls beyond the scope of this study, as this article is not applicable to corporate taxpayers. However, as it falls within the group of “distributive rules articles”, the article is discussed for the sake of completeness.

This article regulates the taxing of salaries, wages and pensions paid by a contracting state to an individual for services to that contracting state only in that contracting state (OECD, 2010:32-33).

Paragraph 2 of the Commentary (OECD, 2010:294) states that the principle of exclusive taxing rights to the paying state is found in so many conventions between OECD member states that it can be said to be internationally accepted. If services are performed in connection with business carried on by the state, the provisions of this article do not apply, but the provisions of Article 15 (Wages and salaries), Article 16 (Directors’ fees), Article 17 (Artistes and sportsmen) and Article 18 (Pensions) applies, according to paragraph 6 of the Commentary (OECD, 2010:297). An observation to the Commentary has been recorded by the Netherlands only (OECD, 2010:297). Reservations have been recorded by the United States and France (OECD, 2010:297).

2.3.4.14 Article 20: Students

The taxation of students falls beyond the scope of this study, as it is not relevant to corporate taxpayers. However, as it falls within the group of “distributive rules articles”, it is discussed for the sake of completeness.

This article is in respect of payments to students or business apprentices who were resident, before visiting a contracting state, in the other contracting state, and who are present in the first contracting state purely for the purposes of education or training (OECD, 2010:33). These payments are not taxed in the contracting state where they are studying or training, on condition that the payments arise from outside that contracting state.

Paragraph 3 of the Commentary (OECD, 2010:298) argues that Article 20 covers payments received for purposes of maintenance, education and training, but not payments received as remuneration for services rendered, where Article 15 or Article 7 will apply. No observations or reservations have been recorded to this article.

2.3.4.15 Article 21: Other income

Article 21 of the OECD Model covers all other income not dealt with specifically in the previous articles. The principle is that income in this category is taxed in the contracting resident state only. The exception is income that arises from immovable property or a permanent establishment in the other contracting state (OECD, 2010:33).

The income covered by this article is income of a class not expressly dealt with and also income from sources not expressly mentioned, according to paragraph 1 of the Commentary (OECD, 2010:299). This is by its very nature a type of “catch-all” provision, and it appears not to be frequently applied, as is confirmed by the survey data.

South Africa has reserved the right to tax income arising from a source in South Africa (OECD, 2010:458).

2.3.4.16 Article 22: Capital

Article 22 of the OECD Model deals with capital represented by immovable property referred to in Article 6, owned by a resident of the resident state, and situated in the other, source state. The capital may be taxed in the source state (OECD, 2010:34).

The article also deals with capital represented by movable property forming part of the business property of a permanent establishment in the source state. Capital represented by ships and aircraft in international traffic and boats engaged in inland waterways transport are taxable only in the state of effective management (OECD, 2010:34). All other elements of capital of a resident of a contracting state are taxable only in the resident state (OECD, 2010:34).

The SADC countries have not recorded a position on this article.

2.3.4.17 Article 23: Methods of eliminating double taxation

Article 23A of the OECD Model provides for the elimination of double taxation by the exemption method. If a resident of a contracting state derives income or owns capital which *may* be taxed in the other contracting state, the contracting resident state must exempt such income or capital from tax (OECD, 2010:34-35).

Paragraph 2 provides for the exemption where the income is dividends or interest, providing for effectively the “credit method” provided for in Article 23B (OECD, 2010:35). The important qualification is that the credit provided is not allowed to exceed that part of the tax that can be attributed to such income derived from the other contracting state, the “ordinary credit method”. Paragraph 3 allows the contracting state of residence to take the exempted income into account in determining the tax rate applicable to the other income of the taxpayer (OECD, 2010:35).

Paragraph 4 provides a safeguard against exemption by both contracting states by allowing the contracting resident state to tax the income where the other contracting state exempts that income from tax (OECD, 2010:35).

The Commentary (OECD, 2010:306-309) opens with preliminary remarks covering both Articles 23A and 23B under the following headings: The scope of the articles, Description of methods for elimination of double taxation, Operation and effects of the methods, The methods proposed in the articles, Conflict of qualification and Timing mismatch.

The Commentary, under the scope of the articles (OECD, 2010:306), indicates that the articles deal with juridical double taxation, where the same income or capital is taxable in the hands of the same person by more than one state. This is different from economic double taxation, where two different persons are taxable in respect of the same income or capital. Economic double taxation has to be solved by two states in bilateral negotiations.

Paragraph 3 of the Commentary (OECD, 2010:306) identifies three cases where juridical double taxation may arise:

- Each contracting state subjects the same person to tax on worldwide income or capital, concurrent full liability for tax, normally on the basis of residence. The conflict is then resolved by the definition of the term “resident of a contracting state” in Article 4 (OECD, 2010:306).
- The person is a resident of a contracting state and derives income from or owns capital in the other contracting state, and both the states impose tax on that income or capital. The conflict may be resolved by the allocation of taxing rights between contracting states. Chapters III and IV of the OECD Model, together with Articles 23A and 23B, govern the allocation. Paragraph 6 (OECD, 2010:307) indicates that the words “shall be taxed only” in a contracting state preclude the other contracting state from taxing, and double taxation is avoided. The state of which the taxpayer is a resident is normally given the exclusive right to tax, except in four articles, namely Article 8 (International transport), Article 13 (Capital gains), Article 19 (Government service) and Article 22 (Capital). The right to taxation for other items of income or capital is not exclusive, as indicated by the words “may be taxed” (OECD, 2010:307).
- The contracting states subject the same person, who is not a resident of either state, to tax on income derived from or capital owned in a contracting state (OECD, 2010:308). There is no provision in the OECD Model for relief to be given by a contracting state for taxes levied in a third state where the income arises.

The Commentary, under Description of methods for eliminating double taxation (OECD, 2010:309), identifies the two leading principles for eliminating double taxation as the exemption principle and the credit principle.

In paragraph 14 of the Commentary (OECD, 2010:309), the two methods by which the principle of exemption may be applied are outlined:

- full exemption (the income that may be taxed in the source state is exempted from tax in the resident state); and
- exemption with progressing (the resident state exempts the income, retaining the right to take the income into account in determining the rate of tax to be applied to the rest of the income) (OECD, 2010:309).

The exemption method is provided for in Article 23A of the OECD Model. The exemption method is advantageous to a taxpayer in the resident state because no tax is then payable in the resident state on the exempted income. This method may hold limited disadvantages for the tax authority in the resident state, because the tax authority foregoes tax where the rate at which tax is payable in the source state is less than the rate of tax in the resident state. The exemption method of elimination of double taxation is a full and complete elimination of double taxation.

In paragraph 15 of the Commentary (OECD, 2010:309), the two methods by which the principle of credit may be applied are outlined:

- full credit (the resident state allows a deduction of the total amount of tax paid in the source state from the tax payable in the resident state); and
- ordinary credit (the resident state limits the credit to the tax chargeable to that income in the resident state).

This ordinary credit method may lead to additional tax (residual double taxation) payable by the taxpayer in total, compared to the tax that would have been payable if the income had come from a source in the resident state. This is particularly common where the tax levied by the source state takes the form of a withholding tax on the gross amount, ignoring the expenditure incurred in producing the gross amount.

The ordinary credit method of elimination of double taxation is not, in all cases, a full and complete method of elimination of double taxation, because the taxpayer in the resident state may suffer some residual double taxation.

Paragraph 17 (OECD, 2010:309) states that the difference between the exemption principle and the credit principle is that the exemption principle looks at the income, while the credit principle looks at the tax on the income. With the exemption method, the resident state gives up fully its right to tax the income concerned, whereas that is not the case with the credit method. The Commentary on the operations and effect of the methods uses a number of examples to illustrate taxation under the exemption method and under the credit method (OECD, 2010:310-312).

The example (OECD, 2010:310) with the full exemption method shows that the relief provided by the resident state may be higher than the tax levied by the source state, because the resident state gives up its income from the source state, and the remaining income from the resident state is also reduced, because it is taxed at the lower rate. The example shows that with the exemption method with progression, the tax of the resident state on the income from the source state is relinquished, but not the higher rate on the remaining income from the resident state. It may be concluded that where the full exemption method is applied, a taxpayer does not pay more tax than if the income derives in total from a source within the resident state.

The example with the full credit method (OECD, 2010:311) shows that the relief by the resident state may be higher than the tax attributable to the foreign source income. The ordinary credit method does not require the resident state to relinquish more tax than that state would ordinarily have levied on the foreign source income. As a result, a resident state taxpayer may end up paying more tax in total than the taxpayer would have paid if the income had in total come from a source in the resident state. This problem may be described as residual double taxation.

In the OECD Model, Table 23.2, “Amount of tax given up by the state of residence”, in the Commentary (OECD, 2010:312) requires closer analysis. The table shows the position only with reference to the foreign source income, and fails to take into account that if the foreign source income had come from a source within the resident state, the taxpayer paying the income might be entitled to a tax deduction, which would mean that the net tax collected by the resident state from both taxpayers would be zero. The resident state may benefit from not having to give a tax deduction at the cost of the resident state taxpayer.

The Commentary on Methods proposed in the articles (paragraph 28) indicates that conventions concluded by OECD member countries follow both the exemption and the credit methods (OECD, 2010:313). The Commentary concludes that, theoretically, a single principle would be more desirable, but each state has the freedom to make its own choice. Paragraph 29 (OECD, 2010:313) states that it has been found important to limit the number of methods based on each leading principle to be employed. The articles of the OECD Model were drafted in such a manner that member countries are free to choose between two methods:

- the exemption method with progression, Article 23A; or
- the ordinary credit method, Article 23B.

The Commentary Conflict of qualification (paragraph 32.1) indicates that the resident state has the obligation to apply the exemption or credit method to income or capital where the convention authorises taxation by the source state (OECD, 2010:314). The Commentary Timing mismatch (paragraph 32.8) states that the resident state must provide relief for double taxation by the exemption or credit method, regardless of when the source state levies the tax (OECD, 2010:316). In paragraph 34 of the Commentary, the exemption method is preferred as the most practical, because it relieves a resident state from having to investigate the actual taxing position in the other state (OECD, 2010:317).

Paragraph 48 argues that where the source state prescribes maximum percentages for tax, the tax rate in the resident state is often higher than the rate allowed by the source state, and therefore the credit method results in a limitation only in a limited number of cases (OECD, 2010:321). The Commentary appears to overlook the fact that the tax rate applied in the source state is mostly a rate on the gross income, whereas the rate in the resident state is a rate applied to gross income reduced by deductions, net taxable income.

Article 23B of the OECD Model provides for the credit method for elimination of double taxation (OECD, 2010:324-328). In cases where a resident of a contracting state derives income or owns capital which *may* be taxed in the other contracting state, the contracting resident state must allow a deduction from the tax on the income or capital of that resident equal to the tax paid in the other contracting state. However, the deduction is not required to exceed that part of the tax which is attributable to the income or capital which may be taxed in the contracting resident state.

Paragraph 3 (OECD, 2010:35) allows a contracting resident state to take the exempted income into account when it determines the rate of tax applicable to the taxpayer's other income. Paragraph 57 of the Commentary (OECD, 2010:324) restates the proviso that "the deduction is restricted to the appropriate proportion of its (resident state) own tax". Paragraph 58 states that the ordinary credit method is also intended where the exemption

method is followed for the tax levied at limited rates in the other state on dividends and interest (OECD, 2010:324).

It is important to recognise that a resident state is only obliged to give relief on an item of income or capital where the item may be taxed by the other state in terms of the convention. In South Africa, it was necessary, in order to assist resident taxpayers, to enact section 6 Quin of the *South African Income Tax Act, Act 58 of 1962*, to provide relief to South African resident taxpayers for tax which is levied by the other state but which is not levied in terms of a DTA. Paragraph 59 (OECD, 2010:325) also indicates that Article 23B relief is available where the income or capital “*may be taxed*” (emphasis added) by the other state. The appropriate relief where the income or capital “*shall be taxed only*” (emphasis added) in the other state is the exemption method in terms of Article 23A (OECD, 2010:325).

In many states, there are rules for credit for foreign tax in domestic law, according to paragraph 60 (OECD, 2010:325). Domestic rules do not affect the principle laid down by Article 23B. This is the case in South Africa, with sections 6 Quat and 6 Quin of the *Income Tax Act*.

The example in paragraph 63 of the Commentary (OECD, 2010:326) illustrates that the maximum deduction in a resident state may be lower than the tax effectively paid in the other state. A taxpayer in the resident state who derives interest from the other state may borrow funds from a third party to finance an interest-producing loan. The interest on such borrowed funds may be deducted in the resident state from the interest derived from the other state (OECD, 2010:326), reducing the net income subject to tax in the resident state. The Commentary points out that this increased tax on the taxpayer in the resident state can be overcome by applying the full credit method in the resident state (OECD, 2010:326). However, the OECD Model advocates the ordinary credit method (partial credit) and this is applied by most countries following the OECD Model.

The Commentary, paragraphs 72 to 79 (OECD, 2010:329-331), covers the topic of “tax sparing”. This is where a state grants tax incentives to foreign investors in order to attract foreign investment. Using the credit method for relief of double taxation reduces tax, due to the tax incentive, in the other state (source state), and then the relief under the credit

method in the resident state negates the tax incentive given by the source state. To avoid this situation, states providing tax incentives to foreign investors include provisions in their conventions which are referred to as “tax sparing” provisions. These provisions force the resident state to give credit for the tax “spared” – this means the resident state gives credit for tax that is not actually due or payable in the source state because of the tax incentive to attract foreign investment.

2.3.5 Relationship with older versions of the OECD Model

Existing conventions should, where possible, be interpreted in the spirit of the revised commentaries (OECD, 2010:15).

2.3.6 Annexure to the OECD Model

The heading of the annexure to the OECD Model, “Recommendations of the OECD Council concerning the Model Tax Convention on Income and Capital”, was adopted by the Council on 23 October 1997. (OECD, 2010:465-466). The annexure contains three recommendations to the governments of Member countries – they should

- pursue their efforts to conclude DTAs with those Member countries and non-member countries with which they do not have DTAs, and to revise DTAs that may no longer reflect present-day needs;
- conform to the OECD Model as interpreted by the Commentaries; and
- follow the Commentaries when applying and interpreting their DTAs.

The OECD Council invites the governments of Member countries to notify the OECD of reservations and observations on the Commentaries and instructs the Committee on Fiscal Affairs to continue its ongoing review of the OECD Model.

Finally, the OECD Council repeals the recommendations of 31 March 1994 and 21 September 1995.

2.4 THE UNITED NATIONS MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES (2011)

This section commences with a brief background introduction to the *United Nations Model Double Taxation Convention between Developed and Developing Countries* (UN Model), in order to illustrate the status of this model as a theoretical underpinning to other model tax conventions and DTAs. The section provides an overview of important elements of the UN Model, particularly the different articles included in the model, to explain to what extent this study uses the UN Model as a theoretical basis.

2.4.1 Background

The various model tax conventions, “particularly the United Nations Model Convention and the OECD Model Tax Convention on Income and on Capital (the OECD Model Convention), have a profound influence on international treaty practice, and have significant common provisions” (UN, 2011:vi). The similarities between the two leading models, the UN Model and the OECD Model, reflect the importance of achieving consistency where possible. The areas of divergence relate mainly to differences in approach in individual countries’ practices. The differences lie in the issue of how far one country or another should forego taxing rights which would be available under domestic law in order to avoid double taxation, and to encourage investment.

According to the UN Model (UN, 2011:vi), the “United Nations Model Tax Convention generally favours retention of greater so called ‘source country’ taxing rights under a treaty ...as compared to those of the ‘residence country’ of the investor”.

The UN Model is the result of the work of the 25-member Committee of Experts on International Cooperation in Tax Matters. The Committee members are nominated by countries and selected by the Secretary General of the United Nations. The members act in their personal capacities for a period of four years (UN, 2011:viii). The Committee members at the time of the 2011 update of the UN Model came from Barbados, Belgium, Brazil, Bulgaria, Chile, China, Egypt, Germany, Ghana, India, Italy, Japan, Malaysia, Mexico, Morocco, New Zealand, Nigeria, Norway, Pakistan, the Republic of Korea,

Senegal, South Africa, Spain, Switzerland and the United States of America. The member from South Africa was Mr R. van der Merwe from the South African Revenue Service (UN, 2011:viii).

The UN Model (UN, 2011:ix) states the following:

The United Nations Model Tax Convention seeks to be balanced in its approach. ... the Articles are based on the recognition by the source country that (a) taxation of income from foreign capital should take into account expenses allocable to the earning of the income so that such income is taxed on a net basis, that (b) taxation should not be so high as to discourage investment and that (c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

The Committee has identified treaty policy issues requiring further work, such as the taxation treatment of services and taxation of fees for technical services (UN, 2011:x).

2.4.2 Differences between the UN model and the OECD model

The title of the UN Model, *United Nations Model Double Taxation Convention between Developed and Developing Countries*, specifically notes the application of the UN Model to DTAs between developed and developing countries.

The most significant differences, discussed under the sub-headings of the articles concerned in the OECD Model that may have a financial effect on South African company taxpayers are analysed below. Note throughout that the UN Model gives more weight to the source principle than the OECD Model does.

2.4.2.1 Article 7: Business profits

Article 7 in the OECD Model (OECD, 2010:26-27) provides for business profits to be taxed in the resident state, except if business is carried on in the source state through a permanent establishment. The corresponding article in the UN Model extends this basis to sales in the source state of goods of “the same or similar kind as those sold through that permanent establishment” (UN, 2011:12) and business activities carried on in the source state of the “same or similar kind” (UN, 2011:13) as carried on through the permanent

establishment where the activities are not carried on through the permanent establishment (UN, 2011:12-14).

The UN Model is more extensive in that it denies the permanent establishment a deduction, other than reimbursement of expenses, for amounts that are paid to the head office of the enterprise or to any other offices, for “royalties, fees or similar payments in return for the use of patents or other rights” (UN, 2011:13), commission or services performed, or for management, and interest on funding to the permanent establishment.

2.4.2.2 Article 12: Royalties

Article 12 in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The UN Model (UN, 2011:18-19) provides for royalties to be taxed in both the contracting states, with a limit on the tax in the source state, where the tax should not exceed an unspecified percentage of the gross royalties.

2.4.2.3 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) differs from the UN Model. The third paragraph of the UN Model (UN, 2011:25) is extended to provide that any other income of a resident of a contracting state may also be taxed in the other contracting state, namely the source state.

2.5 THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAX ON INCOME (2013)

This section opens with a brief introduction to the *Southern African Development Community Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Tax on Income* (the SADC Model), in order to illustrate the status of this model as a theoretical underpinning to other model tax conventions and DTAs. The section provides an overview of important elements contributing to the SADC Model,

particularly the various articles included in the model, to explain the extent to which the current study uses the SADC Model as a theoretical basis.

2.5.1 Technical fees (not in OECD Model)

Technical fees are covered in Article 13 of the SADC Model (SADC, 2013:13). This is in contrast to the OECD Model (OECD, 2010), where technical fees are not covered. The definition contained in Article 13 of the SADC Model covers payments for any services of a technical, managerial or consultancy nature (SADC, 2013:13). The reimbursements of actual expenditure that are incurred by the recipient of the fees are excluded from the definition.

The basis for the taxation of technical fees is that the right to tax is vested in the state of residence of the recipient of the fees. However, the SADC Model also provides taxing rights to the state in which the fees arise, but limits the tax to a percentage of the gross fees. The taxing rights of the state in which the fees arise are exercised by way of a withholding tax at source (SADC, 2013:13).

Lesotho, as a SADC Member country, reserves the right to exclude the exemption on the reimbursement of actual expenses (SADC, 2013:28). Angola and Mauritius reserves the right not to include this article (SADC, 2013:28).

2.5.2 Article 23: Elimination of double taxation

Article 23 of the SADC Model provides for two methods to eliminate double taxation, namely the exemption method and the credit method providing for tax sparing (SADC, 2013:18). The SADC Model, like the OECD Model, allows contracting states to exercise their preference, so two contracting states may apply different methods in the DTA.

2.6 THE SOUTH AFRICAN MODEL AGREEMENT FOR THE AVOIDANCE OF DOUBLE TAXATION (2005)

This section commences with a brief background introduction to the *South African Model Agreement* (South African Model), in order to illustrate the status of this model as theoretical underpinning to other model tax conventions and DTAs. The section provides an overview of important elements in the South African Model to explain the extent to which this study uses the South African Model as a theoretical basis.

The South African Model is an internal SARS document and not available as a public document. However, the South African Model is commented on by Olivier and Honiball (2011:272), and by Mazansky (2009). The South African Model used in this study is not an official SARS document. The South African Model used in this study is in public domain, having been presented to the Parliament Select Committee on Finance on 7 September 2005 as a comparison between the OECD Model, the South African Model and the Agreement between South Africa and Malaysia for Avoidance of Double Taxation and prevention of Fiscal Evasion (Malaysia DTA) on presenting the Malaysia DTA to the South African Parliament for ratification (South Africa, 2005b). Van der Merwe (2015) indicates that to his knowledge there is no later version in the public domain.

2.6.1 Background

The South African Model is the basis for DTAs negotiated by South Africa and follows a combination of OECD Model, the UN Model and the SADC Model (Van der Merwe, 2014).

According to Olivier and Honiball (2011:272), the key features of the South African Model are the following:

- interest is taxed in a recipient's residence state if the recipient is the beneficial owner;
- there is no limit on the rate at which a source state may tax dividends and royalties; and
- the rendering of services, including professional services, gives rise to a permanent establishment if the periods for which these services are rendered exceed 183 days.

2.6.2 Article 11: Interest

In the South African Model, Article 11, interest is taxed only in the state of residence, whereas the OECD Model, Article 11 provides for interest to be taxed in both contracting states, but the tax in the source state may not exceed 10% of the gross interest.

2.6.3 Article 12: Royalties

The South African Model, Article 12 provides for royalties to be taxed in both the contracting states, with a limit on the tax in the source state – the tax may not exceed an unspecified percentage of the gross royalties. This percentage is normally between 5% and 10% of the gross royalties. The OECD Model, Article 12 provides for royalties to be taxed in the state of residence only.

2.6.4 Article 21: Other income

The OECD Model, Article 21, and the South African Model, Article 20 differ in that the South African Model is extended to provide in paragraph 3 that other income of a resident of a contracting state may also be taxed in the source state.

2.6.5 Article 23: Elimination of double taxation

The OECD Model, Article 23A and 23B, provides for two alternative methods to eliminate double taxation. The South African Model, Article 21, has opted for the ordinary credit method as provided for in Article 23B of the OECD Model.

2.6.6 Technical fees (not in OECD Model)

The provisions in a number of South African DTAs allowing the state of residence and the state of source to tax technical fees is not provided for by the OECD Model, the UN Model or the South African Model.

2.7 CONCLUSION

The purpose of this chapter, as stated at the start of the chapter, was to clarify the theoretical basis on which differences between the OECD Model and the DTAs between South Africa and other SADC member countries are identified in this study.

The current study focuses only on DTAs concluded after 1977 between South Africa and member countries of the SADC because these DTAs coincide with or follow the publication in 1977 of the OECD's *Model Double Taxation Convention on Income and on Capital*. DTAs are negotiated over long periods, over years, and therefore it was considered unnecessary for the purposes of this study to be more specific than the year 1977 as a start date.

The stipulations of the OECD Model relevant to corporate taxpayers in South Africa, and those of other models have been discussed in this chapter to clarify the relation of the UN Model, the SADC Model and the South African Model to the OECD Model in the context of this study.

The chapter has provided background and other relevant information on the OECD Model, the UN Model, the SADC Model, the South African Model, and has referred to DTAs between South Africa and member countries of SADC, to clarify the theoretical framework underpinning this study. This theoretical framework is used as basis from which to compare these models and DTAs critically in Chapter 3, with the purpose of identifying differences between them that may affect the net income of corporate taxpayers in South Africa after income tax.

The standing of the OECD Model as the international standard for tax conventions is demonstrated by the fact that it is followed by the 30 OECD Member countries, and by a further 30 non-OECD Member countries with observer status (OECD, 2010:10). It is for this reason that the articles of DTAs concluded between South Africa and SADC member countries are compared to the OECD Model in Chapter 3, where this comparison is also referenced to the UN Model, the SADC Model and the South African Model.

CHAPTER 3: CRITICAL COMPARISON

3.1 INTRODUCTION

The purpose of the current study is to explore the potential financial effects on South African corporate taxpayers of differences between articles included in DTAs that South Africa has concluded with other SADC member countries and corresponding articles in the OECD Model.

The first objective of this chapter is to clarify any differences between articles in the UN Model, the SADC Model, the South African Model, the relevant DTAs and the articles in the OECD Model, using the distributive articles, as classified in Table 1 of the present study. The second objective of this chapter is to illustrate the theoretical financial effects that these identified differences may have on corporate taxpayers in South Africa.

This chapter commences with a critical comparison between the distributive articles in the OECD Model and the distributive articles in the UN Model, the SADC Model, and the South African Model. The chapter then presents an overview of the DTAs between South Africa and other member countries of the SADC, clarifying the extent to which these DTAs are included in this study. This is followed by a critical comparison of these DTAs with the relevant articles from the OECD Model. The chapter then clarifies and illustrates the theoretical effect that these differences may have on the net income after income tax of corporate taxpayers in South Africa. The chapter concludes with a summary.

3.2 CRITICAL COMPARISON OF THE DIFFERENT MODEL TAX CONVENTIONS

This section clarifies which articles in the UN Model, the SADC Model, and the South African Model differ from the OECD Model and may have a financial effect on South African corporate taxpayers.

3.2.1 UN Model

The complete title of the UN Model, the *United Nations Model Double Taxation Convention between Developed and Developing Countries* stresses developed and developing countries. This emphasis provides a clear indication that the UN Model is specifically designed for and applied in DTAs between developed and developing countries.

The various model tax conventions, “particularly the UN Model and the OECD Model, have a profound influence on international treaty practice, and have significant common provisions” (UN, 2011:vi). The similarities between the two leading models, the UN Model and the OECD Model, reflect the importance of achieving consistency where possible. The areas of divergence focus on differences in approach in country practice. The differences relate mainly to the issue of how far one country or another should forego taxing rights which would be available under domestic law in order to avoid double taxation and to encourage investment. The UN Model states that the “United Nations Model Tax Convention generally favours retention of greater so called ‘source country’ taxing rights under a treaty...as compared to those of the ‘residence country’ of the investor” (UN, 2011:vi).

The differences between the UN Model and the OECD Model, under the sub-heading of the article as included in the OECD Model, are analysed below, to show where the differences have a possible financial effect on South African corporate taxpayers. It should be noted that the UN Model gives more weight to the taxing rights of the source state than the OECD Model does.

3.2.1.1 Article 6: Income from immovable property

The provisions in Article 6 of the UN Model (UN, 2011:12) and Article 6 in the OECD Model (OECD, 2010:26) are essentially the same.

3.2.1.2 Article 7: Business profits

Article 7 in the UN Model and the corresponding article in the OECD Model provide for business profits to be taxed in the resident state, except if the business is carried on in the source state by means of a permanent establishment. The UN Model (UN, 2011:12-13) extends this basis of business profits to sales in the source state of goods of the same or a similar kind as sold through the permanent establishment, and to business activities carried on in the source state of the same or a similar kind as carried on through the permanent establishment, where the activities are not carried on through the permanent establishment.

The UN Model (UN, 2011:12-14) is also extended to deny the permanent establishment a deduction, other than reimbursement of expenses, for amounts paid to the head office of the enterprise or any other offices, for royalties, fees or similar payments for the use of patents or other rights, commission or services performed or for management and interest on funding to the permanent establishment.

The financial effect of the differences between the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident and source states, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.1.3 Article 8: Shipping, inland waterways transport and air transport

The provisions of the OECD Model (OECD, 2010:27) allocate taxing rights to the state of effective management, while the UN Model (UN, 2011:14-15) makes provision for alternatives, allocates the taxing rights to the resident state of the enterprise, or to the state of effective management.

The financial effect of the differences between the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident and source states, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.1.4 Article 10: Dividends

Dividends fall outside the scope of the present study, because they fall after net income before tax, and are an item of income that is not subjected to full taxation in terms of South Africa' domestic tax laws. However, because dividends fall in the group of “distributive rules articles”, it is discussed here for the sake of completeness. The provisions in Article 10 in the UN Model (UN, 2011:16-17) and the OECD Model (OECD, 2010:28-29) are substantially the same. The UN Model does not specify the withholding tax percentages.

3.2.1.5 Article 11: Interest

The provisions in Article 11 in the UN Model (UN, 2011:17-18) and the OECD Model (OECD, 2010:29-30) are essentially the same.

3.2.1.6 Article 12: Royalties

Article 12 in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The UN Model (UN, 2011:18-19) provides for royalties to be taxed in both the contracting states, with a limit on the tax in the source state (it should not exceed an unspecified percentage of the gross royalties).

This difference may potentially have a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility where both the resident and the source state are given taxing rights.

3.2.1.7 Article 13: Capital gains

The provisions in Article 13 in the UN Model (UN, 2011:20-21) and the OECD Model (OECD, 2010:30-31) are essentially the same.

3.2.1.8 Articles 14 to 20

These articles apply to natural persons and governments, so they fall outside the scope of this study, as they are not applicable to corporate taxpayers.

3.2.1.9 Article 21: Other income

Article 21 on other income in the UN Model (UN, 2011:25) differs from the corresponding article in the OECD Model (OECD, 2010:33), in that the UN Model extends the article to provide in paragraph 3 that other income of a resident of a contracting state may also be taxed in the other contracting state, the source state.

The financial effect of the differences between the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident and source states, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.1.10 Article 22: Capital

The provisions in Article 22 in the UN Model (UN, 2011:26) and that in the OECD Model (OECD, 2010:34) are essentially the same.

3.2.1.11 Article 23: Methods of eliminating double taxation

The UN Model (UN, 2011:27-28) and the OECD Model (OECD, 2010:34-35) both provide for a choice between the exemption method and the ordinary credit method.

3.2.2 The SADC Model

The SADC published a draft for a model tax convention in 2001. It is likely that when the SADC Draft Model is ratified by all SADC countries this model will be used by member states of the SADC as a basis for their DTA negotiations (Olivier & Honiball, 2011:272).

Since 2001, there has only been limited progress, as the SADC Model has not been ratified by all SADC countries. Nevertheless, many SADC countries are already using the SADC Model as a basis for negotiating DTAs.

The key features of the SADC Draft Model are (Olivier & Honiball, 2011:272):

- the determination of residence qualification is more detailed than in the OECD and UN Models;
- requirements for permanent establishment are less strict than in the OECD and UN Models;
- no deductions are allowed for amounts paid as royalties, certain specialised services or management services by a permanent establishment to its head office;
- the dividend definition differs from that in the OECD Model;
- for royalties, both states have taxing rights, determined through bilateral negotiations;
- specific provision is made for taxing technical fees.

The deviations, where these differences have a possible financial effect on South African corporate taxpayers, are analysed below, under the sub-headings of the comparable article in the OECD Model.

3.2.2.1 Article 6: Income from immovable property

The provisions in Article 6 in the SADC Model (SADC, 2013:7), in the UN Model (UN, 2011:12) and in the OECD Model (OECD, 2010:26) are essentially the same.

3.2.2.2 Article 7: Business income

The provisions in Article 7 in the SADC Model (SADC, 2013:8) and in the OECD Model (OECD, 2010:26-27) are essentially the same.

3.2.2.3 Article 8: Shipping, inland waterways transport and air transport

The provisions of the OECD Model (OECD, 2010:27) allocate taxing rights to the state of effective management, while the SADC Model (SADC, 2013:9) allocates the taxing rights to the resident state of the enterprise. The SADC Model also covers profits from the use or rental of containers under the same article.

The financial effect of the differences between the SADC Model, the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident and source states, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.2.4 Article 10: Dividends

Dividends fall outside the scope of the present study, because they fall after net income before tax and are an item of income that is not subjected to full taxation in terms of South African domestic tax laws. However, as dividends fall within the group of “distributive rules articles”, they are discussed for the sake of completeness. The provisions in Article 10 in the SADC Model (SADC, 2013:10), the UN Model (UN, 2011:16-17) and the OECD Model (OECD, 2010:28-29) are substantially the same. The SADC Model does not specify the withholding tax percentages.

3.2.2.5 Article 11: Interest

Article 11 in the OECD Model (OECD, 2010:29-30) provides for interest to be taxed in both contracting states, with a limit on the tax in the source state – it should not exceed 10% of the gross interest. The SADC Model (SADC, 2013:11) is the same as the OECD Model; however, the withholding tax percentage of gross interest is not prescribed in the SADC Model

3.2.2.6 Article 12: Royalties

Article 12 in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The SADC Model (SADC, 2013:12) provides for royalties to be taxed in both the contracting states, with a limit on the tax in the source state. The tax should not exceed an unspecified percentage of the gross royalties.

This difference may potentially have a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility where both the resident and the source state are given taxing rights.

3.2.2.7 Technical fees (not in OECD Model)

The provisions allowing the resident state and the source state to tax technical fees, as contained in Article 13 of the SADC Model (SADC, 2013:13) is not provided for in the OECD Model. The SADC Model provides for technical fees to be taxed in both the contracting states, with a limit on the tax in the source state, where the tax should not exceed an unspecified percentage of the gross technical fees.

This difference may potentially have a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility only where both the resident and the source state are given taxing rights.

3.2.2.8 Article 13: Capital gains

The provisions in Article 14 in the SADC Model (SADC, 2013:14), which corresponds to Article 13 in the UN Model (UN, 2011:20-21) and the OECD Model (OECD, 2010:30-31), are essentially the same.

3.2.2.9 Articles 15 to 21

These articles apply to natural persons and governments, so they fall outside the scope of this study, as they are not applicable to corporate taxpayers.

3.2.2.10 Article 21: Other income

Article 22 in the SADC Model (SADC, 2013:17) differs from Article 21 on other income in the OECD Model (OECD, 2010:33), in that the SADC Model is extended to provide in paragraph 3 that other income received by a resident of a contracting state may also be taxed in the contracting source state.

The financial effect of the differences between the SADC Model, the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident state and source state, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.2.11 Article 23: Methods of eliminating double taxation

The OECD Model (OECD, 2010:34-35) provides for a choice between the exemption method and the ordinary credit method, whereas the SADC Model (SADC, 2013:18) makes no recommendation.

3.2.3 South African Model tax agreement

The South African Model is the basis for DTAs negotiated by South Africa and follows a combination of OECD Model's, the UN Model's, and the SADC Model's provisions. (Van der Merwe 2014).

The key features of the South African Model are the following (Olivier & Honiball, 2011:272):

- interest is taxed in the recipient's residence state if the recipient is the beneficial owner;

- there is no limit on the rate at which the source state may tax dividends and royalties; and
- the rendering of services, including professional services, gives rise to a permanent establishment if the periods exceed 183 days.

The deviations, where these differences have a possible financial effect on South African corporate taxpayers, are analysed below under the sub-heading of the corresponding article of the OECD Model.

3.2.3.1 Article 6: Income from immovable property

The provisions in Article 6 in the South African Model, the SADC Model (SADC, 2013:7), the UN (UN, 2011:12) and in the OECD Model (OECD, 2010:26) are essentially the same.

3.2.3.2 Article 7: Business income

The provisions in article 7 in the South African Model, the SADC Model (SADC, 2013:7-8) and in the OECD Model (OECD, 2010:26-27) are essentially the same.

3.2.3.3 Article 8: Shipping and air transport

The provisions of the OECD Model (OECD, 2010:27) allocate taxing rights to the state of effective management, while the South African Model allocates the taxing rights to the resident state of the enterprise. The South African Model also covers profits from the use or rental of containers under the same article.

The financial effect of the differences between the South African Model, the SADC Model, the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident and source states, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.3.4 Article 10: Dividends

Dividends fall outside the scope of the present study, because they fall after net income before tax and are an item of income that is not subjected to full taxation in terms of South African domestic tax laws. However, as dividends fall within the group of “distributive rules articles”, they are discussed for the sake of completeness. The provisions in Article 10 in the South African Model, the SADC Model (SADC, 2013:10-11), the UN Model (UN, 2011:16-17) and the OECD Model (OECD, 2010:28-29) are substantially the same. The South African Model does not specify the withholding tax percentages.

3.2.3.5 Article 11: Interest

Article 11 in the OECD Model (OECD, 2010:29-30) provides for interest to be taxed in both contracting states, with a limit on the tax in the source state, not exceeding 10% of the gross interest. The South African Model provides for interest to be taxed only in the state of residence. If the South African Model is followed in DTAs between South Africa and SADC member countries, South African corporate taxpayers as resident state corporate taxpayers are protected against double taxation because the taxing rights are given exclusively to the resident state. However, thus far, the South African Model has not been followed in a single DTA between South Africa and any SADC member countries.

3.2.3.6 Article 12: Royalties

Article 12 in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South African Model provides for royalties to be taxed in both the contracting states, with a limit on the tax in the source state, not exceeding an unspecified withholding tax percentage of the gross royalties. This percentage is normally negotiated as 10% of the gross royalties. The exception is 5%, in the DTA with Mozambique (South Africa, 2009b).

This difference potentially has a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely.

Double taxation is a possibility only where both the resident and the source state are given taxing rights.

3.2.3.7 Article 13: Capital gains

The provisions in Article 13 in the South African Model, which corresponds to Article 14 in the SADC Model (SADC, 2013:14), and to Article 13 in the UN Model (UN, 2011:20-21) and the OECD Model (OECD, 2010:30-31), are essentially the same.

3.2.3.8 Articles 14 to 20

These articles apply to natural persons and governments, so they fall outside the scope of this study, as they are not applicable to corporate taxpayers.

3.2.3.9 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33), Article 20 in the South African Model, differ in that the South African Model is extended to provide in paragraph 3 that other income of a resident of a contracting state may also be taxed in the other contracting state as the source state.

The term “other income” is not defined, however the following definition may be deduced from the article itself: other income refers to items of income of a resident of a contracting state not dealt with in the foregoing articles of the Convention. This article is therefore a stop gap or catch all article.

The financial effect of the differences between the South African Model, the SADC Model, the UN Model and the OECD Model on South African corporate taxpayers is limited to the difference in the corporate tax rate between the resident state and source state, because tax is levied on the net taxable income, and not by a withholding tax on the gross amount.

3.2.3.10 Article 22: Capital

Article 22 on capital as found in the OECD Model (OECD, 2010:34) is omitted from the South African Model.

3.2.3.11 Article 23: Elimination of double taxation

Article 23A and 23B in the OECD Model (OECD, 2010:34-35) provides for two alternative methods for elimination of double taxation. The South African Model, in Article 21, opts for the ordinary credit method as in Article 23B of the OECD Model. The South African Model is not prescriptive as to the method used to eliminate double taxation for the other state.

The South African Model contains a proviso that 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 shall not affect the general principle. The effect of this provision is that South African resident taxpayers are entitled to an election between domestic law, section 6 Quat of the *Income Tax Act, Act 58 of 1962* (South Africa, 1962), and the provisions of the applicable DTA for the elimination of double taxation.

The advantage of section 6 Quat of the *Income Tax Act* (South Africa, 1962) over the DTA provisions is that section 6 Quat contains a carry-forward provision in cases where the relief does not cover the full foreign tax. The further advantage under section 6 Quat is that the deduction method for relief from double taxation is available, which is not currently available under the existing South African DTAs with SADC countries.

The alternative to the elimination of double taxation subject to the law of South Africa is available under the South African DTAs with the following SADC countries covered by the present study: Botswana, the DRC, Mozambique, Seychelles, Swaziland and Tanzania (South Africa, 2002, 2004, 2005, 2007, 2009b, 2012). This alternative is not provided for under the South African DTAs with the following SADC countries covered by the present study: Lesotho, Mauritius and Namibia (South Africa, 1997a, 1997b, 1999).

Neither the OECD Model, the UN Model nor the SADC Model provide for an election by the taxpayer between DTA relief and domestic law relief. The advantage of taxpayer election between DTA and domestic law relief is that the deduction method for elimination of double taxation is provided for in South African domestic law, although it is not provided for in any of the models or DTAs considered in this study. The advantage to South African corporate taxpayers as resident state corporate taxpayers is demonstrated in Section 5.3.4 of the current study.

3.2.3.12 *Technical fees (not in OECD Model)*

The provisions allowing the resident state and the source state to tax technical fees, as contained in a number of South African DTAs, is not provided for in the OECD Model, the UN Model or in the South African Model. This provision appears only in the SADC Model as Article 13 (SADC, 2013:13).

This difference potentially has a financial impact on South African corporate taxpayers as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility where both the resident state and the source state are given taxing rights.

3.2.4 Summary of findings

This section summarises the results of the critical comparison of the UN Model, the SADC Model, and the South African Model, using the OECD Model as an underpinning where the other models differ from the OECD Model. The critical comparison is on the basis that these items are not connected to a permanent establishment in the source state. Table 2, overleaf provides a summarised overview of the findings. The possible financial effects that the deviations may have on the corporate taxpayers in South Africa are clarified in the notes below Table 2, overleaf.

Table 2: Deviations of other models from the OECD Model

Articles	OECD Model	UN Model	SADC Model	South African Model
OECD Model distributive articles:				
Article 7: Business income (Note 1)	Resident state (2.3.4.2)	Resident plus limited force of attraction (3.2.1.2)	Resident state (3.2.2.2)	Resident state (3.2.3.2)
Article 11: Interest. (Note 2)	Source state WHT 10% (2.3.4.5)	Source state WHT 10% (3.2.1.5)	Source state WHT unspecified rate (3.2.2.5)	Resident state exclusively (3.2.3.5)
Article 12: Royalties. (Note 3)	Resident state (2.3.4.6)	Source state WHT unspecified rate (3.2.1.6)	Source state WHT unspecified rate (3.2.2.6)	Source state WHT unspecified rate (3.2.3.6)
Article 21: Other income (Note 4)	Resident state (2.3.4.15)	Resident and source states (3.2.1.9)	Resident and source states (3.2.2.10)	Resident and source states (3.2.3.9)
Articles not in the OECD Model:				
Technical fees (Note 5)	Resident state by default	Resident state by default	Source state WHT unspecified rate (3.2.2.7)	Resident state by default

The possible effects that the deviations indicated in Table 2, above, may have on the corporate taxpayers in South Africa are clarified in the following notes:

Note 1 Business Income:

In terms of the UN Model, the taxing rights of the source state are extended to sales in the source state of goods of the same or a similar kind as sold through the permanent establishment, and business activities carried on in the source state of the same or a similar kind as carried on through the permanent establishment, where the activities are

not carried on through the permanent establishment. This is a countermeasure against abuse by not channelling sales through the permanent establishment.

- Note 2 Interest:

In terms of the OECD Model, the UN Model and SADC Model, the state of residence and the state of source have taxing rights which may lead to double taxation. In terms of the South African Model, the state of residence has exclusive taxing rights. If the South African Model is followed in DTAs between South Africa and SADC member countries, South African corporate taxpayers as resident state corporate taxpayers are protected against double taxation, because the taxing rights are given exclusively to the resident state. However, the South African Model is not followed in a single current DTA between South Africa and SADC member countries.

- Note 3 Royalties:

In terms of the OECD Model, the state of residence has exclusive taxing rights with no possibility of double taxation. In terms of the UN Model, the SADC Model and the South African Model, the state of residence and the state of source have taxing rights. This difference potentially has a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility where both the resident and the source state are given taxing rights.

- Note 4 Other Income:

In terms of the OECD Model, the state of residence has exclusive taxing rights, with no possibility of double taxation. In terms of the UN Model, the SADC Model and the South African Model, the state of residence and the state of source have taxing rights. This difference potentially has a financial impact on South African corporate taxpayers, as resident state corporate taxpayer, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility only where both the resident and the source state are given taxing rights.

- Note 5 Technical Fees:

The SADC Model is the only model that provides for technical fees. The OECD Model, the UN Model and the South African Model do not provide specifically for technical fees, and therefore Article 7 on business profits or Article 21 on other income may

apply. In terms of the SADC Model, the state of residence and the state of source have taxing rights. The SADC Model provides that the reimbursement of expenditure is excluded from the definition of technical fees and not subject to withholding tax. This difference potentially has a financial impact on South African corporate taxpayers, as resident state corporate taxpayers, because the OECD Model provides exclusive taxing rights to the resident state, thus eliminating the possibility of double taxation completely. Double taxation is a possibility where both the resident and the source state are given taxing rights.

Daurer (Daurer, 2014:279-280) developed a model article for technical fees, providing the resident state taxpayer to be taxed in the source state on the basis of a permanent establishment on net taxable income despite not having a permanent establishment in the source state.

Only deviations from the OECD Model as explained in Notes 1 to 5 above have a possible financial effect on corporate taxpayers in South Africa. Hence, from this point forward, only these OECD Model articles (Articles 7, 11, 12 and 21), and the provisions on technical fees (not in the OECD Model, but in the SADC Model), are used as basis from which the OECD Model is compared to the DTAs that South Africa has concluded with SADC member countries.

3.3 DTAs BETWEEN SOUTH AFRICA AND SADC MEMBER COUNTRIES

The predecessor to the SADC, the Southern African Development Coordination Conference (SADCC) was established in Lusaka, Zambia, in 1980. In 1992, the Heads of Government of the Region agreed to transform the SADCC into the SADC (SADC, n.d.a). The purposes of the SADCC carried forward into the SADC are (SADC, n.d.b)

- reducing member state dependence especially (but not only) on apartheid South Africa;
- forging linkages to create equitable regional integration;
- mobilising member state resources to promote the implementation of national, interstate and regional policies; and
- taking concerted action to secure international cooperation within the framework of the strategy for economic liberation.

It is desirable to clarify, standardise and confirm the fiscal situation of taxpayers engaged in commercial, industrial, financial or other activities in more than one country by ensuring that all countries apply common solutions to identical cases of double taxation (OECD, 2010:7). This point of departure implies that the purpose of model tax conventions is to provide a framework for countries in which they can negotiate DTAs. The emphasis of the OECD Model is on DTAs between developed countries. In the UN Model the emphasis is on DTAs between developed and developing countries. The SADC Model has a regional emphasis, and the South African Model a national emphasis.

Tables 3 to 5 clarify the scope of this study by summarising the relationship between SADC and South Africa with reference to existing DTAs, Protocols and renegotiations.

Table 3: Members of the Southern Africa Development Community (SADC)

Country			
Angola	Malawi	Seychelles	Zambia
Botswana	Mauritius	South Africa	Zimbabwe
DRC	Mozambique	Swaziland	
Lesotho	Namibia	Tanzania	

Source: SADC (n.d.c)

At the time of the current study, South Africa had not yet concluded a DTA with Angola. Table 4, below, provides a summary of the DTAs concluded between SADC member countries and South Africa, as well as an indication of when each DTA was concluded with the country in question.

Table 4: South African DTAs with SADC Countries

SADC member country	Government Gazette, and date	Effective date
Botswana	26342 dd 12/5/2004	20/4/2004
DRC	35805 dd 24/10/2012	18/7/2012
Lesotho	17948 dd 22/4/1997	9/1/1997
Malawi	1479 dd 6/12/1971	2/9/1971
Mauritius	18111 dd 2/7/1997	20/6/1997
Mozambique	31983 dd 13/3/2009	19/2/2009

Namibia	19780 dd 19/2/1999	11/4/1999
Seychelles	25646 dd 30/10/2003	29/7/2002
Seychelles Protocol	35396 dd 6/6/2012	15/5/2012
Swaziland	27637 dd 1/6/2005	8/2/2005
Tanzania	30039 dd 4/7/2007	15/6/2007
Zambia	Proclamations 174 of 1956 and 60 of 1960	31/8/1956
Zimbabwe	1234 dd 24/9/1965	3/9/1965

Source: Adapted from SARS (2015)

The current study focuses on DTAs concluded after 1977 between South Africa and member countries of the SADC. Therefore the DTAs with Malawi, Zambia and Zimbabwe are not included in the study. The reason for only focusing on DTAs concluded after 1977 is that these DTAs coincide with the publication in 1977 of the *OECD Model Double Taxation Convention on income and on Capital* in Paris.

Table 5, below, provides a summary of the DTAs under renegotiation or Protocols under negotiation between SADC member countries and South Africa at the time of this study. These renegotiations and protocols, when ratified, may have an impact that differs from the findings recorded in this study.

Table 5: South African negotiations with SADC Countries

SADC member country	Status
Botswana	Protocol
Lesotho	Renegotiation
Malawi	Renegotiation
Mauritius	Renegotiation
Mozambique	Protocol
Namibia	Renegotiations
Swaziland	Protocol
Zambia	Renegotiation
Zimbabwe	Renegotiation

Source: Adapted from SARS (2015)

As explained in Section 3.2.4 above, only Articles 7, 11, 12 and 21 of the OECD Model and the construct of technical fees are used as basis from which the OECD Model is

compared to the DTAs that South Africa has concluded with the SADC member countries. The Article numbers in the DTA may differ from those used in the OECD Model, but the OECD article numbers are used to structure the discussion. Where the DTA numbers differ, this is indicated in the discussion.

3.3.1 DTA with Botswana

The South Africa/Botswana DTA was concluded on 12 May 2004. The deviations are analysed to ascertain where they could have a financial effect on South African corporate taxpayers.

3.3.1.1 Article 11: Interest

Interest arising in a contracting state (the source state) and paid to the resident of the other contracting state (the resident state) may be taxed in the resident state. However, such interest may also be taxed in the source state, but the tax charged may not exceed 10% of the gross amount of the interest.

The South Africa/Botswana DTA follows the OECD Model. A possible financial effect for South African corporate taxpayers does not arise from any difference from the OECD Model, but from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Hence, where the expenditure incurred in producing the interest income exceeds a certain ratio to the interest received subject to withholding tax, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.1.2 Article 12: Royalties

Royalties arising in a contracting state (the source state) and paid to the resident of the other contracting state (the resident state) may be taxed in the resident state.

The DTA, in paragraph 2, allows the contracting state in which the royalties arise to tax the royalties. However, if the beneficial owner of the royalties is a resident of the other contracting state, the tax is limited to 10% of the gross amount of the royalties. Paragraph 3 of the DTA defines the term “royalties” as a “payment of any kind as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design, plan, secret formula or process, or *for information concerning industrial commercial or scientific experience*” (emphasis added)(South Africa,2004:11).

The principle in the OECD Model (OECD, 2010:30) is that royalties arising in a contracting state and beneficially owned by a resident of the other contracting state *shall* be taxable only in that other contracting state (the resident state) is not followed in the South Africa/Botswana DTA.

The DTA adopts the fall-back provision to Article 7, business profits, where royalties are connected to a permanent establishment, and the transfer pricing position, where the royalties are excessive, as a result of a special relationship between the parties in the OECD Model.

South Africa recorded a position on this article in the OECD Model, reserving the right to add a provision defining the source of royalties. This position is followed in paragraph 5 of the South Africa/Botswana DTA.

The possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation will not be complete, resulting in residual double taxation.

3.3.1.3 Technical fees (not in OECD Model)

Technical fees are not covered in the OECD Model. Article 20 in the South Africa/Botswana DTA does cover technical fees (South Africa, 2004:15-16). The principle,

in terms of paragraph 1, is that technical fees arising in a contracting state (the source state) derived by a resident of the other contracting state (the resident state) may be taxed in that resident state. However, in terms of paragraph 2, such technical fees may also be taxed in the source state in which the technical fees arise – this tax is limited to 10% of the gross amount of the technical fees where the technical fees are derived by a resident of the resident state.

The term “technical fees” covers, in terms of paragraph 3, payment for administrative, technical, managerial or consultancy services. This represents a complete deviation from the principles contained in the OECD Model.

The possible financial effect for the South African corporate taxpayer arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the technical fee income exceeds 64.25% of the technical fee income, the elimination of double taxation will not be complete, resulting in residual double taxation.

3.3.1.4 Article 21: Other income

The principle in the OECD Model (OECD, 2010:33) followed by the South Africa/Botswana DTA (South Africa, 2004:16) is that all other income not dealt with specifically in the previous articles is taxed in the contracting resident state only, except for income arising from immovable property or a permanent establishment in the other contracting state (the source state). However, the South Africa/Botswana DTA contains a provision in paragraph 3 of Article 21 that is not found in the OECD Model:

Notwithstanding the provisions of paragraph 1 and 2, items of income of a resident of a contracting state not dealt with in the foregoing articles of the convention and arising in the other contracting state may also be taxed in that other state. (South Africa, 2004:16)

There is no limit on the taxing rights on either the source or the resident states. Furthermore, there is no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model (see, paragraph 3.2.1

subparagraph 6, UN, 2011:ix), it follows that both states tax other income on a net basis, allowing expenditure incurred in producing the income to be deducted.

The possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination of double taxation is not complete, resulting in residual double taxation.

This article covers income of a class not expressly dealt with, and also income from sources not expressly mentioned, as explained in paragraph 1 of the Commentary (OECD, 2010:299). This article is a type of “catch-all” provision.

3.3.2 DTA with the Democratic Republic of the Congo (DRC)

This DTA concluded by South Africa with the DRC became effective on 18 July 2012. The deviations from the OECD Model that may have a financial effect on South African corporate taxpayers are discussed below.

3.3.2.1 Article 11: Interest

Interest arising in a contracting state (source state) and paid to the resident of the other contracting state (resident state) may be taxed in the resident state. However, the interest may also be taxed in the source state. This tax may not exceed 10% of the gross amount of the interest. In this respect, the South Africa/DRC DTA follows the OECD Model.

The possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the interest income exceeds 64.25% of the interest received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.2.2 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South Africa/DRC DTA provides for royalties to be taxed by both contracting states. The tax in the source state is limited to 10% of the gross amount.

The principle in the OECD Model is that royalties arising in a contracting state and beneficially owned by a resident of the other contracting state *shall* be taxable only in that other contracting state (the resident state) is not followed in the South Africa/DRC DTA.

This DTA adopts the fall-back provision to Article 7, Business profits (where royalties are connected to a permanent establishment) and the transfer pricing position where the royalties are excessive as a result of a special relationship between the parties in the OECD Model.

South Africa recorded a position on this article in the OECD Model (OECD, 2010:250), reserving the right to add a provision defining the source of royalties. This position is followed in paragraph 5 of the South Africa/DRC DTA (South Africa, 2011:11)

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation is not complete, resulting in residual double taxation.

3.3.2.3 Article 21: Other income

The principle in Article 21 of the OECD Model (OECD, 2010:33) and in Article 20 in this DTA that is followed by the South Africa/DRC DTA is that all other income not dealt with specifically in the previous articles is taxed in the contracting resident state only, except for income arising from immovable property or a permanent establishment in the other contracting state (as the source state).

However, the South Africa/DRC DTA contains a provision in paragraph 3 of Article 20 that is not found in the OECD Model. It states:

Notwithstanding the provisions of paragraph 1 and 2, items of income of a resident of a contracting state not dealt with in the foregoing articles of the convention and arising in the other contracting state may also be taxed in that other state. (South Africa, 2012:15)

There is no limit on the taxing rights on either the source or the resident states. There is also no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model, paragraph 3.2.1 subparagraph 6 (UN, 2011:ix), it must follow that both states tax other income on a net basis, allowing expenditure incurred in producing the income as a deduction.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination of double taxation is not complete, resulting in residual double taxation.

The income covered by this article is income of a class not expressly dealt with, and is also income from sources not expressly mentioned in paragraph 1 of the Commentary (South Africa, 2012:15). This article is a type of “catch-all” provision.

3.3.3 DTA with Lesotho

The DTA concluded by South Africa with Lesotho became effective on 19 January 1997. The deviations from the OECD Model that have a possible financial effect on the South African corporate taxpayer are discussed below.

3.3.3.1 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state. The South Africa/Lesotho DTA provides for royalties to be taxed by both contracting states, but the tax in the source state is limited to 10% of the

gross amount (South Africa, 1997a:11). This represents a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.3.2 *Technical fees (not in OECD Model)*

Technical fees are not covered in the OECD Model. Article 13 on technical fees in the South Africa/Lesotho DTA provides for technical fees to be taxed in both contracting states. The tax in the source state is limited to 10% of the gross amount (South Africa, 1997a:12). Technical fees are not provided for in the OECD Model. This represents a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the technical fee income exceeds 64.25% of the technical fee income, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.3.3 *Article 21: Other Income*

The principle in Article 21 of the OECD Model (OECD, 2010:33), and this is followed by the South Africa/Lesotho DTA (South Africa, 1997a:15), is that all other income not dealt with specifically in the previous articles are taxed in the contracting resident state only.

3.3.4 DTA with Mauritius

This DTA concluded by South Africa with Mauritius became effective on 20 June 1997. The South Africa/Mauritius DTA (South Africa, 1997b:1-19) agrees with the OECD Model in all significant respects. There are no differences which may have a financial effect on South African corporate taxpayers.

3.3.5 DTA with Mozambique

This DTA concluded by South Africa with Mozambique became effective on 19 February 2009. The deviations from the OECD Model which have a possible financial effect on South African corporate taxpayers are discussed below.

3.3.5.1 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South Africa/Mozambique DTA (South Africa, 2009b:11) provides for royalties to be taxed by both contracting states. The tax in the source state limited to 5% of the gross amount. This represents a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 82.14% of the royalties received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.5.2 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) provides for other income to be taxed in the resident state only. The South Africa/Mozambique DTA (South Africa, 2009b:15) provides for other income to be taxed in both contracting states.

There is no limit on the taxing rights on either the source or the resident states. There is also no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model, paragraph 3.2.1 subparagraph 6 (UN, 2011:ix), it must follow that both states tax other income on a net basis, allowing expenditure incurred in producing the income as a deduction.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination of double taxation is incomplete, resulting in residual double taxation. This article is by nature a “catch-all” provision.

3.3.6 DTA with Namibia

The DTA concluded by South Africa with Namibia became effective on 11 April 1999. The deviations from the OECD Model which have a possible financial effect on South African corporate taxpayers are discussed below.

3.3.6.1 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South Africa/Namibia DTA (South Africa, 1999:11) provides for royalties to be taxed by both contracting states. The tax in the source state is limited to 10% of the gross amount. This represents a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.6.2 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) provides for other income to be taxed in the resident state only. Article 22 of the South Africa/Namibia DTA (South Africa, 1999:15) provides for other income to be taxed in the source state only. This effectively results in the elimination of double tax in the resident state by the exemption method, provided for in article 23A of the OECD Model (OECD, 2010:32-33), as the resident state is prohibited from taxing the income.

3.3.7 DTA with Seychelles

The DTA concluded by South Africa with the Seychelles became effective on 29 July 2002 and the Protocol became effective on 15 May 2012. The only deviation from the OECD Model which has a possible financial effect on the South African corporate taxpayer is Article 21 (Other income).

3.3.7.1 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) provides for other income to be taxed in the resident state only. Article 22 of the South Africa/Seychelles DTA (South Africa, 2002:8) provides for other income to be taxed in both contracting states. There is no limit on the taxing rights on either the source or the resident states. There is also no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model, paragraph 3.2.1 subparagraph 6 (UN, 2011:ix), it must follow that both states tax other income on a net basis, allowing expenditure incurred in producing the income as a deduction.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination

of double taxation is not complete, resulting in residual double taxation. This article is a “catch-all” provision.

3.3.8 DTA with Swaziland

The DTA concluded by South Africa with Swaziland became effective on 8 February 2005. The deviations from the OECD Model which have a possible financial effect on the South African corporate taxpayer are discussed below.

3.3.8.1 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South Africa/Swaziland DTA (South Africa, 2005:10) provides for royalties to be taxed by both contracting states. The tax in the source state is limited to 10% of the gross amount. This is a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.8.2 Technical fees (not in OECD Model)

Technical fees are not covered in the OECD Model. Article 13 on technical fees in the South Africa/Swaziland DTA (South Africa, 2005:11) provides for technical fees to be taxed in both contracting states. The tax in the source state is limited to 10% of the gross

amount. This represents a complete deviation from the principles contained in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the technical fee income exceeds 64.25% of the technical fee income, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.8.3 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) provides for other income to be taxed in the resident state only. Article 21 of the South Africa/Swaziland DTA (South Africa, 2005:15) provides that other income *may* be taxed in the source state.

There is no limit on the taxing rights on either the source or the resident state. There is also no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model, paragraph 3.2.1 subparagraph 6 (UN, 2011:ix), it must follow that both states tax other income on a net basis, allowing expenditure incurred in producing the income as a deduction.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.9 DTA with Tanzania

The DTA concluded by South Africa with Tanzania became effective on 15 June 2007. The deviations from the OECD Model which have a possible financial effect on South African corporate taxpayers are discussed below.

3.3.9.1 Article 12: Royalties

Article 12 on royalties in the OECD Model (OECD, 2010:30) provides for royalties to be taxed in the resident state only. The South Africa/Tanzania DTA (South Africa, 2007:11) provides for royalties to be taxed by both contracting states. The tax in the source state is limited to 10% of the gross amount. This deviates completely from the principles in the OECD Model.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the expenditure incurred in producing the royalty income exceeds 64.25% of the royalties received, the elimination of double taxation is incomplete, resulting in residual double taxation.

3.3.9.2 Article 21: Other income

Article 21 on other income in the OECD Model (OECD, 2010:33) provides for other income to be taxed in the resident state only. Article 20 of the South Africa/Tanzania DTA (South Africa, 2007:15) provides that other income *may* be taxed in the source state.

There is no limit on the taxing rights of either the source or the resident state. There is also no provision for taxing by either state in the form of a withholding tax on the gross amount. In terms of the principle in the UN Model, paragraph 3.2.1 subparagraph 6 (UN, 2011:ix), it must follow that both states tax other income on a net basis, allowing expenditure incurred in producing the income as a deduction.

A possible financial effect for South African corporate taxpayers arises from the fact that in South Africa the ordinary credit method is applied to eliminate double taxation. Where the corporate tax rate in the source state is higher than in South Africa (28%), the elimination of double taxation is incomplete, resulting in residual double taxation. This article is a “catch-all” provision.

3.3.10 Summary of findings

This section summarises the results of the critical comparison of the South African DTAs with SADC countries, and the OECD Model to ascertain where these DTAs differ from the OECD Model. Table 6, overleaf, provides a summarised overview of the findings.

Table 6: Deviations of SADC DTAs from the OECD Model

DTA	Article 12: Royalties	Technical fees	Article 21: Other income
OECD	Resident state (2.3.4.6)	Resident state	Resident state (2.3.4.15)
Botswana	Source state WHT 10% (3.3.1.2)	Source state WHT 10% (3.3.1.3)	Resident and source states (3.3.1.4)
DRC	Source state WHT 10% (3.3.2.2)	Resident state	Resident and source states (3.3.2.3)
Lesotho	Source state WHT 10% (3.3.3.1)	Source state WHT 10% (3.3.3.2)	Resident State (3.3.3.3)
Mozambique	Source state WHT 5% (3.3.5.1)	Resident state	Resident and source states (3.3.5.2)
Namibia	Source state WHT 10% (3.3.6.1)	Resident state	Source state (3.3.6.2)
Seychelles	Resident state	Resident state	Resident and source states (3.3.7.1)
Swaziland	Source state WHT 10% (3.3.8.1)	Source state WHT 10% (3.3.8.2)	Resident and source states (3.3.8.3)
Tanzania	Source state WHT 10% (3.3.9.1)	Resident state	Resident and source states (3.3.9.2)

The possible financial effects of the deviations indicated in Table 6 above on corporate taxpayers in South Africa arise because, in terms of the OECD Model, the state of residence has exclusive taxing rights, with no possibility of double taxation. In terms of DTAs where the state of residence and the state of source both have taxing rights, this may lead to double taxation.

The results summarised in Table 6 indicate deviations from the OECD Model which are used in the next section, as an underpinning for the theoretical framework for the current study. Scenario analysis is used in the empirical research section of this study. The next section clarifies this scenario analysis.

3.4 RESIDUAL DOUBLE TAXATION: SCENARIO ANALYSIS

Residual double taxation refers to the financial/economic effect of the elimination of double taxation being incomplete under certain conditions where elimination of double taxation is by the ordinary credit method.

The measurement for juridical double taxation and residual double taxation is; the taxation chargeable on the resident state taxpayer on a transaction with a party in another state is greater than the taxation chargeable on the resident state taxpayer on an identical transaction with a party within the resident state (self-developed).

The first objective of this chapter was to identify differences between articles in the UN Model, the SADC Model, the South African Model, and selected DTAs, compared to the relevant articles in the OECD Model, because such differences may have a financial effect on corporate taxpayers in South Africa.

The second objective of this chapter is to illustrate, in the form of a scenario analysis, the possible financial effects that the identified differences may theoretically have on the net income after income tax of corporate taxpayers in South Africa.

In many states, there are rules for credit for foreign tax in domestic law, paragraph 60 (OECD, 2010:35). Domestic rules do not affect the principle laid down by Article 23B of the

OECD Model (OECD, 2010:35). However, this provision could provide the taxpayer with a choice as to whether the DTA or the domestic law applies. This is the case in South Africa with sections 6 Quat and 6 Quin of the *Income Tax Act*.

Elimination of double taxation in terms of South African domestic laws, in line with the Deduction method, provided for in section 6 Quat of the *Income Tax Act*, is possible in terms of the South Africa DTAs where the provision DTA is subject to the provisions of the law of South Africa.

The scenario analysis refers to break-even points (where the possible financial effect may be zero) for situations where the ordinary credit method is used to eliminate double taxes and where the deduction method is applied.

Scenario analysis can be broadly defined as a systematic framing of uncertain possibilities (Swart, Raskin & Robinson, 2004:140). Scenario analysis is an accepted tool for predictive analysis, and several studies constructing scenarios can be found in the literature (Postma & Liebl, 2005:162). Hence, a scenario analysis approach was deemed an effective method for this study, to summarise and illustrate possible financial effects on corporate taxpayers in South Africa arising from differences between DTAs and the OECD Model.

The scenario analysis in this study looked at the constructs of company tax rates, withholding tax rates and expenditure levels as the independent variables that must be considered to establish the extent to which the net income after tax (as a dependent variable) may be affected by differences between individual DTAs and the OECD Model, as summarised in Table 6 (above). The role of each of the independent variables in the scenario analysis should be interpreted as follows:

- Company tax rates:

A company tax rate of 28% was used as the point of departure, because it is the rate at which companies in South Africa are taxed. Company tax rates of 25% and 30% were used as company tax rates on either side of the South African corporate tax rate. The break-even point chart in Figure 1 (see page 80) uses the full spectrum of company tax rates from 20% to 50%.

- Withholding tax rates:

A withholding tax rate at 10% was used, because it is the most common rate applied in model tax conventions and DTAs. The break-even point chart in Figure 1 uses the full spectrum of withholding tax rates from 5% through to 20%.

- Expenditure level:

For elimination of double taxation by the ordinary credit method, the ratio of expenditure to gross amount received, subject to a withholding tax of 64.25% was used to illustrate the break-even point, where there is zero residual double taxation. An expenditure ratio of 70% was used as a rate higher than 64.25% to illustrate residual double taxation. The break-even point chart in Figure 1 uses the full spectrum of expenditure ratios from zero to 100%.

The ratio of expenditure to gross amount is used in this study to emphasise expenditure levels. The margin between expenditure and the gross amount may also be used.

For elimination of double taxation by the deduction method, the ratio of expenditure to gross amount received, subject to a withholding tax of 90%, was used to illustrate the break-even point where residual double taxation is smaller with the use of the ordinary credit method, as it is with the deduction method, and an expenditure ratio of 100% was used as a rate higher than 90% to illustrate that residual double taxation is smaller when the deduction method is used than with the use of the ordinary credit method.

The scenario analysis is presented first for a situation where the ordinary credit method is used to eliminate double taxation. Then the situation where the deduction method is applied is presented. Each of the scenarios illustrates the break-even points (where the possible financial effect may be zero), taking into account the independent variables as explained above. For the purposes of the scenario analysis, the methods are defined as follows:

- Ordinary Credit method:

In this method of elimination of double taxation, the resident state gives resident state taxpayers credit against taxes payable in the resident state for taxes paid in another

state (the source state). This credit is limited to the taxes that the resident state levies on that item of income.

- Full Credit method:

In this method of elimination of double taxation, the resident state also gives resident state taxpayers credit against taxes payable in the resident state for taxes paid in another state (the source state), but the credit is *not* limited to the taxes that the resident state levies on that item of income.

- Deduction method:

In this method for elimination of double taxation, the resident state allows resident state taxpayers a tax deduction, in determining taxable income, of the taxes paid in another state (the source state).

Table 7: Credit method break-even point

	WHT at 10% expenditure at 64.25%	WHT at 10% expenditure at 70%
Gross Amount	1,000.0	1,000.0
Expenditure	642.5	700.0
Net Taxable	357.5	300.0
Tax at 28%	100.0	84.0
Withholding Tax	100.0	100.0
Residual Double Taxation	Nil	16.0

Source: Self-developed

Table 7, above, indicates that there is residual double taxation for a South African corporate taxpayer if the expenditure ratio to amount received exceeds 64.25% for withholding tax at 10%. This is the result of the fact that the South African tax credit, under the ordinary credit method, does not cover the full withholding tax.

In terms of South African domestic law, relief from double taxation is available by the deduction method. The deduction method and the ordinary credit method yield identical results for South African corporate taxpayers at an expenditure level of 90% of income, withholding tax at 10% and a corporate tax rate of 28%. In terms of this scenario, the

deduction method for relief of double taxation is beneficial to South African corporate taxpayers where expenditure levels exceed 90% of the gross amount.

Table 8: Deduction method break-even point

	WHT at 10% expenditure at 90%	WHT at 10% expenditure at 100%
Gross Amount	1,000	1,000
Expenditure	900	1,000
Net Taxable	100	Nil
Tax at 28%	28	Nil
Withholding Tax	100	100
Residual Double Taxation	72	100
Deduction Method Relief Tax at 28%	28	28
Residual Double Taxation	72	72
Benefit of Deduction Method over Credit Method	Nil	28

Source: Self-developed

In the DTAs that South Africa has with SADC countries, withholding tax is at a level of 10% throughout, except for the 5% on royalties specified in the DTA with Mozambique. There is residual double taxation when the expenditure ratio to amount received exceeds 82.14% for withholding tax at 5%, because the South African tax credit, under the ordinary credit method, does not cover the full withholding tax. The break-even point between relief in terms of the ordinary credit method and the deduction method is at the level of expenditure to the gross amount of 95% for withholding tax at 5%, irrespective of the corporate tax rate.

3.4.1 Different tax rates

Table 9, below, assumes a withholding tax of 10% of the gross amount and corporate tax rates of 25% and 30% respectively on the net taxable income.

Table 9: Break-even point

	TAX RATE 25%	TAX RATE 30%
Gross Amount	1,000	1,000

	TAX RATE 25%	TAX RATE 30%
Expenditure at 60% and 67%	600	667
Net Taxable	400	333
Tax	100	100
Withholding Tax	100	100
Residual Double Taxation	Nil	Nil

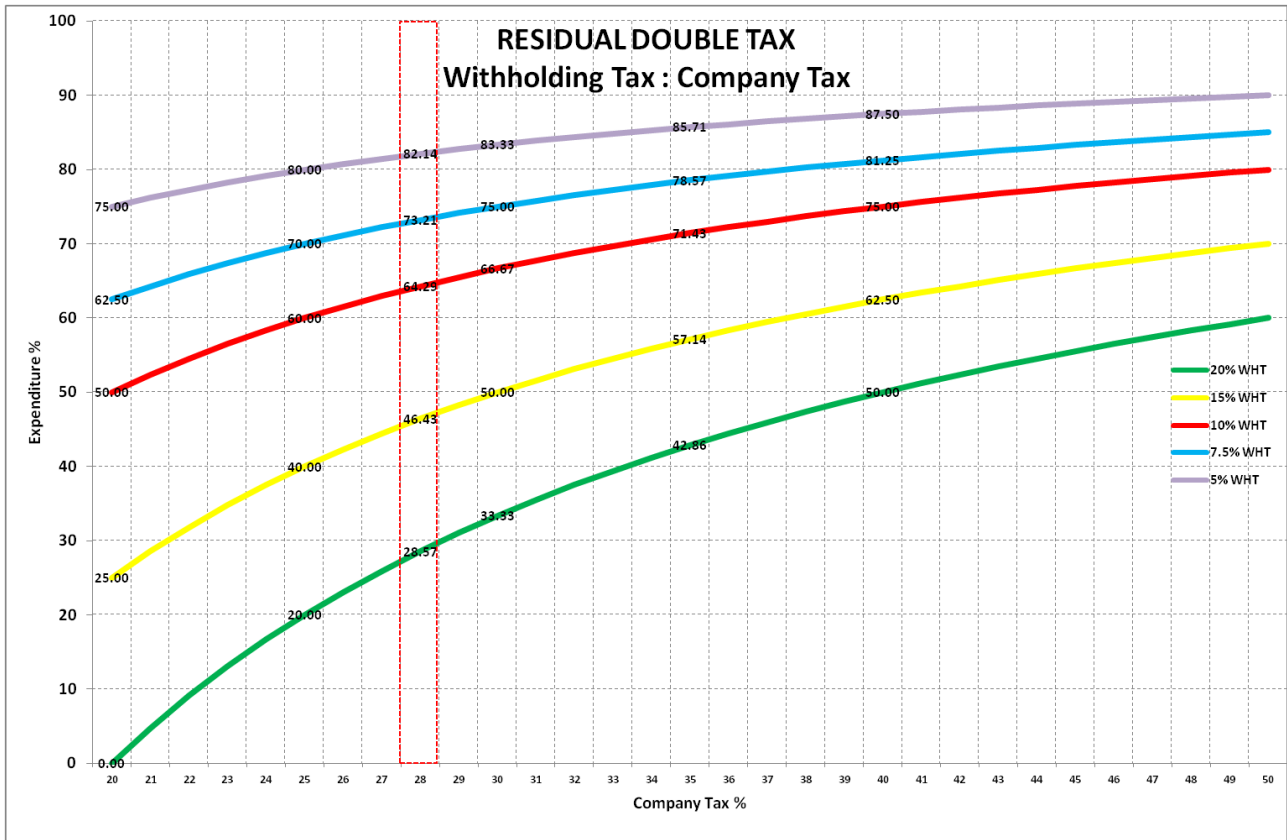
Source: Self-developed

The lower the company tax rate, the lower the expenditure to income ratio, where the break-even-point is reached. There is residual double taxation when the expenditure ratio to amount received exceeds 60% at a resident state corporate tax rate of 25%, or 64.25% at a corporate tax rate of 28%, or 66.67% at a corporate tax rate of 30%, because the resident state tax credit, under the ordinary credit method, does not cover the full withholding tax. The break-even point between relief in terms of the ordinary credit method and the deduction method is at the level of expenditure to the gross amount of 90% for withholding tax at 10%, irrespective of the corporate tax rate.

3.4.2 Summary

The results of the scenario analyses above are summarised and illustrated in Figure 1, below. Figure 1 illustrates the theoretical break-even points for the different scenarios discussed above.

Figure 1: Break-even point chart



Source: Self-developed

Figure 1 shows withholding tax on a gross amount at different rates, ranging from 5% to 20%, with the levels of expenditure incurred to produce the gross amount on the vertical (y) axis. Corporate tax rates on net taxable income from 20% to 50% are shown on the horizontal (x) axis. For example, for withholding tax at 10% on the gross amount and a corporate tax rate on net taxable income of 25%, residual double taxation manifests under the ordinary method for elimination of double taxation at expenditure levels exceeding 60% of the gross amount.

Where double taxation arises from a withholding tax on gross income in the source state, relief from double taxation by the exemption method, the credit method and the deduction method provides no relief for companies in an assessed loss position. Relief from double taxation by the full credit method provides relief for companies that are in assessed loss positions.

The hypothesis derived from the scenario analysis is that resident state corporate taxpayers suffer residual double taxation where a source state applies a withholding tax on

the gross amount, where the expenditure incurred in producing the income subject to withholding tax exceeds certain ratios to the gross amount, and where the resident state applies the ordinary credit method to eliminate double taxation. This is not the case where the full credit method is applied to eliminate double taxation.

The provision for interest, as covered in Article 11 in all the DTAs considered in this study, is in line with that of the OECD Model (OECD, 2010:29-30), but resident state corporate taxpayers suffer residual double taxation where the expenditure, interest on funding giving rise to the interest income, exceed certain ratios to the gross amount interest.

The interest case indicates that residual double taxation is not primarily a result of deviations from the OECD Model, but rather a result of the operation of the methods applied to provide relief from double taxation.

3.5 CONCLUSION

The objectives of this chapter were to identify differences between articles in the UN Model, the SADC Model, the South African Model, the selected DTAs and the articles in the OECD Model, as well as to illustrate the financial effects that these identified differences may theoretically have on corporate taxpayers in South Africa.

This chapter has provided a critical comparison between the distributive articles in the OECD Model and the distributive articles in the UN Model, the SADC Model, and the South African Model. The chapter has also provided a critical comparison between the OECD Model and the DTAs that South Africa has concluded with Botswana, the DRC, Lesotho, Mauritius, Mozambique, Namibia, the Seychelles, Swaziland and Tanzania. The chapter then proceeded to illustrate the financial effect that the identified differences may theoretically have on corporate taxpayers in South Africa, using a scenario analysis method to clarify these effects.

The theoretical financial effect, as concluded from the hypothesis derived from the scenario analysis (see Section 3.4), is used in the next chapter to underpin the exploration of this theoretical construct in a real-world context.

CHAPTER 4: RESEARCH DESIGN AND METHODOLOGY

4.1 INTRODUCTION

The main objective of the current study is to explore the potential financial effects on South African corporate taxpayers of differences between articles included in DTAs that South Africa has concluded with SADC member countries, and the corresponding articles in the OECD Model.

The purpose of this chapter is to clarify the research design and methodology adopted in this study to explore this phenomenon in a real-world context, using scenario analysis as a theoretical framework. The chapter starts with an orientation on the research design and then proceeds to clarify the research methodology.

4.2 RESEARCH ORIENTATION

The research is exploratory. It is hoped that it will encourage further research and debate on the topic in future. The study does not use statistical hypothesis testing – instead, it is qualitative, with an interpretive orientation. The purpose of the research is to achieve an in-depth understanding of the phenomenon, rather than to generalise the findings to a wider population, as described by Henning *et al.* (2004:3). The research is abductive, initially following an inductive approach, building a theory, and then testing the theory using a deductive approach. The time horizon of the study is cross-sectional, as the study looks at a particular phenomenon at a particular time.

The research was conducted in two phases. The first phase consisted of an analysis of the literature, a critical comparison between the DTAs concluded by South Africa with SADC countries and various Model Conventions, and the formulation of a theoretical framework

in the form of a scenario analysis. The second phase was an empirical phase, where the phenomenon was explored in a real-world context, using a survey as a research strategy.

4.3 RESEARCH STRATEGY

The study adopted a survey as its research strategy, using a standard questionnaire to collect data from companies listed on the Johannesburg Stock Exchange (JSE).

A survey research strategy was deemed an acceptable method to collect primary data for this study. Survey research is most appropriate when the central questions of interest about the phenomenon relate to what is happening, and how and why it is happening (Pinsonneault & Kraemer, 1993).

4.4 THE DATA AND ITS COLLECTION

The purpose of the research in this study was to collect primary data from JSE-listed companies that could be used to test the theoretical framework with quantitative data from real-world companies.

4.4.1 The population

The population under review was companies listed on the JSE. The Top 40 companies, by market capitalisation, listed on the JSE Ltd.'s FTSE/JSE SWIX Top 40 Index, were selected as a sample.

4.4.2 Sample selection

The study did not use statistical hypothesis testing, because the study is qualitative, with an interpretive orientation. The purpose of the research was to understand the phenomenon in depth, rather than to understand the relationship between variables, as described by Henning *et al.* (2004:3).

The research adopted a purposive sampling strategy. Purposive sampling is a practical and efficient tool when used properly, and can be just as effective as, and more efficient than, random sampling. It is critical to be certain of the knowledge and skill of the informant when doing purposive sampling (Tongco, 2007).

The target respondents were heads of tax in listed companies. This choice made purposive sampling the ideal tool for this study, because there can be no doubt about the knowledge and skill of the informants about the data required to test the theoretical framework.

The survey questionnaire was sent to the Top 40 companies, by market capitalisation, listed on the JSE's FTSE/JSE SWIX Top 40 Index. Only four companies responded. However, this response rate did not materially affect this study, as the study was exploratory in nature, and the data from the limited responses supported the scenario framework.

4.4.3 Data collection instrument

The data were collected by means of a standard questionnaire that contained specific questions, mainly closed-ended questions. This may be considered an effective method of gathering financial information in a tax environment.

The questionnaire was primarily designed to obtain specific financial information from the respondents on withholding taxes withheld from payments originating in SADC countries, and the expenditure incurred by the respondents in producing the income subject to such a withholding tax in the SADC countries. The standard questionnaire used in the current study is appended to the study as Annexure 3.

4.4.4 Data collection

The research focused on sensitive financial information supplied by the participants. Therefore, informed consent was obtained from each of the participants in the research. The informed consent forms explain the confidentiality with which the information will be

treated and the anonymity of each participant in detail. The approval of all the relevant parties was obtained where necessary, and the approval of the Research Ethics Committee of the Faculty of Economic and Management Sciences at the University of Pretoria was obtained before the fieldwork commenced. A copy of the Committee's letter of authorisation appears in Annexure 4.

The request for participation in the study was sent in an initial e-mail, between 25 March 2014 and 3 April 2014. For each company, the questionnaire was attached. One e-mail went to each company head of tax, and a second e-mail was sent to the company heads of tax who had not responded on 6 May 2014. There was no further contact with the companies making up the population or the respondents.

The head of tax is the responsible official for tax matters in a company, and is the right person to take responsibility for the gathering of the information needed and the completion of the questionnaire in a tax study. The necessary e-mail addresses were obtained from PricewaterhouseCoopers Johannesburg (PricewaterhouseCoopers, 2014).

4.5 SUMMARY

The survey questionnaire was sent to the Top 40 companies, by market capitalisation, listed on the JSE's FTSE/JSE SWIX Top 40 Index, but only four companies responded. This was acceptable in this study, because the study is exploratory and the data from the limited responses supported the scenario framework.

The data obtained from some respondents may indicate allocation inconsistencies, where the expenditure incurred in producing income was exceptionally low in relation to the income, or where no expenditure was allocated. One respondent commented that it is difficult to determine the actual cost. Where allocation inconsistencies were present in the data from certain respondents, the results are not invalidated, as data obtained from the other respondents supported the scenario framework.

The results support the hypothesis that resident state company taxpayers suffer double taxation or residual double taxation where a source state applies a withholding tax on the gross amount, and where the expenditure incurred in producing that income exceeds

certain ratios to the gross amount, where the resident state applies the ordinary credit method to eliminate double taxation. It is possible to conclude from the results that the theoretical scenario framework may provide a basis from which to determine whether a company runs the risk of residual double taxes.

The main objective of this study was to explore the effects that differences between articles included in DTAs that South Africa has concluded with SADC member countries, and the corresponding articles in the OECD Model, may have on South African corporate taxpayers.

The key deviation between the OECD Model and South African DTAs with SADC countries that may have a financial effect on South African corporate taxpayers was identified in the study as allowing the source state to withhold tax on royalties and technical fees. These withholding taxes have a financial effect, identified in this study as residual double taxation, on the South African corporate taxpayers where the ratio of expenditure in producing the gross amount to the gross amount exceeds certain limits.

The research process did not produce the results expected, namely that the financial effect on South African corporate taxpayers in the form of residual double taxation would be primarily a result of deviations between the OECD Model and South Africa's DTAs with SADC countries. Instead, the results confirmed that the financial effect on South African corporate taxpayers in the form of residual double taxation is primarily a result of the application of the ordinary credit method to eliminate double taxation provided for in Article 23B of the OECD Model.

CHAPTER 5: DATA ANALYSIS

5.1 INTRODUCTION

The main objective of the current study was to explore the financial effects that differences between articles included in DTAs which South Africa has concluded with SADC member countries and the corresponding articles in the OECD Model might have on South African corporate taxpayers.

In this chapter, the data obtained from the survey questionnaire are analysed and interpreted. The chapter explains the data analysis technique and then presents the results of the data analysis. The chapter explains the conclusions on the data and the analysis process.

5.2 THE DATA ANALYSIS TECHNIQUE

In developing the hypothesis in the scenario analysis phase of the study, theoretical amounts were used in the theoretical framework to illustrate various scenarios that potentially affect the net income after tax of corporate taxpayers in South Africa. In the data collection phase of the study, the theoretical framework was used to underpin the collection of the quantitative data required to explore the scenario analysis in a real-world context. The same structure used to construct the various theoretical scenarios (see Section 3.4) was adopted to analyse the real-world data that were collected.

The theoretical break-even point under the ordinary credit method used the actual gross amount and the actual withholding tax to calculate the expenditure representing the theoretical break-even point. In this respect, tables 10 to 19 must be interpreted as indicating residual double taxation if the actual expenditure is higher than the calculated expenditure at the break-even point.

5.3 RESULTS

The data obtained from each of the respondents are not necessary in the public domain, although these companies are listed on the JSE as public companies. Hence, the identity of each of the respondents is treated as confidential – the respondents are referred to as Company A, Company B, Company C and Company D. The results for each of the responding companies are presented below.

5.3.1 Company A

Company A is listed in the Top 40 JSE-listed companies. In the survey response, the Head of Tax of Company A indicated that the company receives technical fees and that tax is withheld on these fees in Swaziland. Table 10 summarises the financial position of the company in comparison with the break-even points illustrated in Figure 1 in the current study.

Table 10: Company A – comparative results: Technical fees Swaziland

Detail	Company A Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	15,284	15,284	
Expenditure	Nil	9,827	
Net Taxable	15,284	5,457	
Tax at 28%	4,280	1,528	
Withholding Tax	1,528	1,528	
Withholding Tax deduction			1,528
Tax at 28% on deduction			428
Residual Double Taxation	n/a	Nil	1,100

The data obtained from Company A, allocating no expenditure to the technical fees received subjected to withholding tax in Swaziland, may reveal allocation inconsistencies.

In this case, there is no residual double taxation because the ordinary credit method to eliminate double taxation fully covers the withholding tax levied in Swaziland – the

expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R9,827.

Residual double taxation of R1,100 would result if the deduction method to eliminate double taxation were applied. This alternative method to eliminate double taxation would clearly not be applied in this case.

5.3.2 Company B

Company B is listed in the Top 40 JSE-listed companies. The Head of Tax of the company indicated that Company B receives interest on which tax is withheld in Botswana. Interest is also received from Namibia, where tax is not withheld. Company B also receives technical fees on which tax is withheld in Botswana and Swaziland. Tables 11 to 13 summarise the financial position of Company B in comparison with the break-even points illustrated in Figure 1.

Table 11: Company B – comparative results: Interest Botswana

Detail	Company B Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	2,623,411	2,623,411	
Expenditure	Nil	1,698,407	
Net Taxable	2,623,411	925,004	
Tax at 28%	734,555	259,001	
Withholding Tax	259,001	259,001	
Withholding Tax deduction			259,001
Tax at 28% on deduction			72,520
Residual Double Taxation	n/a	Nil	186,481

This company indicated interest received of R2,623,411 from Botswana, on which withholding tax of R259,001 was charged. The company did not indicate having incurred expenditure in producing the interest received. This may indicate funding entirely from own capital, or may reveal allocation inconsistencies.

The company also indicated interest received of R1,735,946 from Namibia on which no withholding tax was charged, and indicated no expenditure in producing the interest received.

The data obtained from Company B, allocating no expenditure to the interest received subjected to withholding tax in Botswana and Namibia, may indicate that funding came entirely from own capital, or may reveal allocation inconsistencies.

In this case, no residual double taxation manifests, as the ordinary credit method to eliminate double taxation fully covers the withholding tax levied in Botswana and Namibia, because the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R1,698,407.

Residual double taxation of R186,481 would result if the deduction method to eliminate double taxation were applied. This alternative method to eliminate double taxation would clearly not be applied in this case.

Table 12: Company B - comparative results: Technical fees – Botswana

Detail	Company B Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	5,626,344	5,626,344	
Expenditure	2,032,704	3,682,190	
Net Taxable	3,593,640	1,944,154	
Tax at 28%	1,006,219	544,363	
Withholding Tax	554,363	544,363	
Withholding Tax deduction			544,363
Tax at 28% on deduction			152,422
Residual Double Taxation	n/a	Nil	391,941

Company B indicated technical fees received of R5,626,344 from Botswana, with expenditure incurred in earning the fees of R2,032,704, and withholding tax of R554,363 charged. The ratio of expenditure incurred and the technical fees received is 36.13%.

In this case, no residual double taxation will manifest, because the ordinary credit method to eliminate double taxation fully covers the withholding tax levied in Botswana, since the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R3,682,190.

Residual double taxation of R391,941 would result if the deduction method to eliminate double taxation were applied. This alternative method of elimination of double taxation would clearly not be applied in this case.

Table 13: Company B - comparative results: Technical fees – Swaziland

Detail	Company B Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	1,772,160	1,772,160	
Expenditure	942,707	1,139,246	
Net Taxable	829,453	632,914	
Tax at 28%	232,247	177,216	
Withholding Tax	177,216	177,216	
Withholding Tax deduction			177,216
Tax at 28% on deduction			49,620
Residual Double Taxation	n/a	Nil	127,596

Company B also received technical fees of R1,772,160 from Swaziland, with expenditure incurred in earning the fees of R942,707, and withholding tax of R177,216 charged. The ratio of expenditure incurred and the technical fees received is 53.20%.

No residual double taxation will manifest, because the ordinary credit method to eliminate double taxation fully covers the withholding tax levied, since the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R1,139,246.

Residual double taxation of R127,596 would result if the deduction method to eliminate double taxation were applied. This alternative method to eliminate double taxation would clearly not be applied in this case.

5.3.3 Company C

Company C is listed in the Top 40 JSE-listed companies. The Head of Tax of the company indicated that the company receives interest on which tax is withheld in Botswana. Interest is also received from Namibia on which tax is not withheld. The company receives technical fees on which tax is withheld in Botswana. Tables 14 and 15 summarise the financial position of the company in comparison with the break-even points illustrated in Figure 1.

Table 14: Company C – comparative results: Interest

Detail	Company C Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	774,241	774,241	
Expenditure	nil	500,002	
Net Taxable	774,241	274,239	
Tax at 28%	216,787	76,787	
Withholding Tax	76,439	76,787	
Withholding Tax deduction			76,787
Tax at 28% on deduction			21,500
Residual Double Taxation	n/a	Nil	55,287

Company C indicated interest received of R774,241 from Botswana on which withholding tax of R76,439 was charged. The company did not indicate having incurred any expenditure in producing the interest received.

The company also indicated interest received of R745,730 from Namibia on which no withholding tax was charged and indicated no expenditure in producing the interest received.

The data obtained from Company C indicating no expenditure allocated to the interest received subject to withholding tax in Botswana and Namibia may indicate funding entirely from own capital, or allocation inconsistencies.

In this case, no residual double taxation will manifest, as the ordinary credit method to eliminate double taxation fully covers the withholding tax levied in Botswana and Namibia because the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R500,002.

Residual double taxation of R55,287 would result if the deduction method to eliminate double taxation were applied. This alternative method of elimination of double taxation would clearly not be applied in this case.

Table 15: Company C - comparative results: Technical fees – Botswana

Detail	Company C Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	3,363,095	3,363,095	
Expenditure	533,033	2,175,895	
Net Taxable	2,830,062	1,187,200	
Tax at 28%	792,417	332,416	
Withholding Tax	332,416	332,416	
Withholding Tax deduction			332,416
Tax at 28% on deduction			93,076
Residual Double Taxation	n/a	Nil	229,340

Company C indicated technical fees received of R3,363,095 from Botswana with expenditure incurred in earning the fees of R533,033, and withholding tax of R332,416 charged. The ratio of expenditure incurred and the technical fees received is 15.85%.

In this case, no residual double taxation will manifest as the ordinary credit method to eliminate double taxation fully covers the withholding tax levied, since the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R2,175,895.

Residual double taxation of R229,340 would result if the deduction method to eliminate double taxation were applied. This alternative method to eliminate double taxation would clearly not be applied in this case.

5.3.4 Company D

Company D is listed in the Top 40 JSE-listed companies. The Head of Tax of the company indicated that the company receives interest on which tax is withheld in Swaziland. Technical fees are received on which tax is withheld in Botswana, Lesotho and Swaziland. Tables 16 to 19 summarise the financial position of Company D in comparison with the break-even points illustrated in Figure 1.

Table 16: Company D – comparative results: Interest – Swaziland

Detail	Company D Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	3,683,177	3,683,177	
Expenditure	nil	2,367,756	
Net Taxable	3,683,177	1,315,421	
Tax at 28%	1,031,290	368,318	
Withholding Tax	368,318	368,318	
Withholding Tax deduction			368,318
Tax at 28% on deduction			103,129
Residual Double Taxation	n/a	Nil	265,189

Company D indicated interest received of R3,683,177 from Swaziland on which withholding tax of R368,318 was charged. The company did not indicate having incurred any expenditure in producing the interest received. This may indicate that funding came entirely from own capital, or may reveal allocation inconsistencies.

In this case, no residual double taxation will manifest, because the ordinary credit method to eliminate double taxation fully covers the withholding tax levied, since the expenditure incurred in producing the gross amount is lower than the theoretical break-even point expenditure of R2,367,756.

Residual double taxation of R265,189 would result if the deduction method to eliminate double taxation were applied. This alternative method to eliminate double taxation would clearly not be applied in this case.

Table 17: Company D – comparative results: Technical fees – Botswana

Detail	Company D Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	9,292,075	9,292,075	
Expenditure	9,302,865	6,105,018	
Net Taxable	(10,790)	3,187,057	
Tax at 28%	nil	892,376	
Withholding Tax	892,376	892,376	
Withholding Tax deduction			872,376
Tax at 28% on deduction			244,265
Residual Double Taxation	892,376	Nil	648,111

Company D indicated technical fees received of R9,292,075 from Botswana with expenditure incurred in earning the fees of R9,302,865, and a withholding tax of R892,376 charged. The ratio of expenditure incurred and the technical fees received is 100.12%.

In this case, residual double taxation R892,376 would manifest because the ordinary credit method to eliminate double taxation would not fully cover the withholding tax levied, since the expenditure incurred in producing the gross amount is higher than the theoretical break-even point expenditure of R6,105,018.

The deduction method to eliminate double taxation is clearly beneficial in this case, as it results in reduced residual double taxation of R648,111, compared to the residual double taxation of R892,376 under the ordinary credit method to eliminate double taxation.

Table 18: Company D – comparative results: Technical fees – Lesotho

Detail	Company D Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	21,954,854	21,954,854	
Expenditure	20,712,126	14,113,836	
Net Taxable	1,242,728	7,841,018	
Tax at 28%	347,964	2,195,485	
Withholding Tax	2,195,485	2,195,485	
Withholding Tax deduction			2,195,485
Tax at 28% on deduction			614,736
Residual Double Taxation	1,847,521	Nil	1,580,749

The technical fees received from Lesotho were R21,954,854, and expenditure incurred in earning the fees of R20,712,126, and withholding tax of R2,195,485 charged. The ratio of expenditure incurred and the technical fees received is 94.34%.

In this case, residual double taxation R1,847,521 manifests, because the ordinary credit method to eliminate double taxation does not fully cover the withholding tax levied, since as the expenditure incurred in producing the gross amount is higher than the theoretical break-even point expenditure of R14,113,836.

Elimination of double taxation in terms of South African domestic laws, hence the deduction method, provided for in section 6 Quat of the *Income Tax Act*, is not available in terms of the South Africa/Lesotho DTA. The provision “subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any other country other than South Africa” is not contained in Article 22 of the South Africa/Lesotho DTA.

If the deduction method for elimination of double taxation had been available, it would clearly have been beneficial in this case, because it would result in reduced residual double taxation of R1,580,749, compared to the residual double taxation of R1,847,521 under the ordinary credit method to eliminate double taxation.

Table 19: Company D – comparative results: Technical fees – Swaziland

Detail	Company D Data	Theoretical break-even point	
		Ordinary Credit method	Deduction method
Gross Amount	27,235,990	27,235,990	
Expenditure	25,694,330	17,506,994	
Net Taxable	1,541,660	9,728,996	
Tax at 28%	431,665	2,724,119	
Withholding Tax	2,724,119	2,724,119	
Withholding Tax deduction			2,724,119
Tax at 28% on deduction			762,753
Residual Double Taxation	2,292,454	nil	1,961,366

The technical fees received from Swaziland amounted to R27,235,990 with expenditure incurred in earning the fees of R25,694,330, and withholding tax of R2,724,119 charged. The ratio of expenditure incurred and the technical fees received is 94.34%.

This data obtained from Company D, as for technical fees, indicate a high ratio of expenditure in earning the technical fees, well above the 64.25% point, and thereby provides confirmation for the scenario analysis that residual double taxation occurs for South African corporate taxpayers for withholding tax at 10% of the gross amount at an expenditure ratio above 64.25% at the South African corporate tax rate of 28%. In this case, residual double taxation R2,292,454 manifests because the ordinary credit method to eliminate double taxation does not fully cover the withholding tax levied, since the expenditure incurred in producing the gross amount is higher than the theoretical break-even point expenditure of R17,506,994.

The deduction method to eliminate double taxation is clearly beneficial in this case, as it results in reduced residual double taxation of R1,961,366, compared to the residual double taxation of R2,292,454 under the ordinary credit method to eliminate double taxation. The data obtained from Company D, as for technical fees, indicates that in each case the residual double taxation is less if the deduction method to eliminate double taxation is applied as the alternative provided for in South African domestic legislation.

South African corporate taxpayers as resident state corporate taxpayers would not have suffered double taxation or residual double taxation if the DTAs followed the OECD Model, as the OECD Model does not grant taxing rights to the source state on technical fees.

However, if the identical ratio of expenditure to gross amount had been in respect of interest, the DTAs would have been in line with the OECD Model, and these corporate taxpayers would have been subjected to double taxation or residual double taxation. This leads to the conclusion that double taxation or residual double taxation is not the primary result of deviations from the OECD Model, but rather the primary reason for double taxation or residual double taxation is the application of the ordinary credit method to eliminate double taxation provided for in the OECD Model in Article 23B, which does not completely eliminate double taxation.

5.4 DISCUSSION AND CONCLUSION

The data analysis indicates that three of the participating companies, Companies A, B and C, did not suffer double taxation or residual double taxation. The ordinary credit method to eliminate double taxation provided full credit for the withholding tax at source. This is because the ratio of expenditure to gross amount did not exceed the theoretical break-even point of 64.25%.

The data analysis indicates that participating Company D did not suffer double taxation or residual double taxation on interest. The ordinary credit method to eliminate double taxation provided full credit for the withholding tax at source. This is because the ratio of expenditure to gross amount did not exceed the theoretical break-even point of 64.25%.

However, the data analysis indicates that participating Company D did suffer double taxation or residual double taxation on technical fees. The ordinary credit method to eliminate double taxation did not provide full credit for the withholding tax levied in the source state. This is because the ratio of expenditure to gross amount exceeded the theoretical break-even point of 64.25%.

The results presented above lead to the conclusion that a resident state company taxpayer suffers double taxation or residual double taxation where the source state applies a withholding tax on the gross amount, and the expenditure incurred in the production of that income exceeds certain ratios to the gross amount, where the resident state applies the ordinary credit method to eliminate double taxation. It is possible to conclude from the results that the theoretical scenario framework may provide a basis from which to determine whether a company risks facing residual double taxes.

The results of the research process were not based on a wide sample. However, the fact that the data collected from a single company (Company D) confirms residual double taxation under certain ratios of expenditure incurred in producing the gross amount makes it possible to conclude that the scenario framework has some validity in a wider context than this study.

CHAPTER 6: SUMMARY AND CONCLUSION

6.1 INTRODUCTION

The main objective of this study was to explore the possible financial effects of differences between articles included in DTAs that South Africa has concluded with SADC member countries, and the corresponding articles in the OECD Model on South African corporate taxpayers. In pursuit of this main objective, the study adopted a number of sub-objectives. One of these was to identify differences that potentially have a financial impact on South African corporate taxpayers by comparing the DTAs that South Africa has concluded with SADC member countries with the OECD Model, considering the UN Model, the SADC Model and the South African Model. Another of these objectives was to clarify the theoretical framework needed to explore this phenomenon empirically in a real-world context.

6.2 SUMMARY OF FINDINGS AND CONCLUSIONS

The purpose of this study, as outlined in Chapter 2, paragraph 2.1 was to explore the effects of differences between articles included in DTAs that South Africa has concluded with SADC member countries, and corresponding articles in the OECD Model on the net income after income tax of South African corporate taxpayers.

The objective in Chapter 2 was to clarify the theoretical basis on which differences between the OECD Model on the one hand, and the DTAs between South Africa and other SADC member countries on the other hand, were identified in this study. The chapter provided an overview of the literature, details on the OECD Model, the UN Model, the SADC Model and the South African Model, clarifying the extent to which these models were used as a theoretical basis in the current study.

The first objective of Chapter 3 was to clarify any differences between articles in the UN Model, the SADC Model, the South African Model, the relevant DTAs and the articles in the OECD Model, using the distributive articles from Table 1 of the present study. The second objective of this chapter was to illustrate the financial effects that the identified differences may theoretically have on corporate taxpayers in South Africa.

Chapter 3 commenced with a critical comparison between the distributive articles in the OECD Model and the distributive articles in the UN Model, the SADC Model, and the South African Model. The chapter reviewed the relevant articles of the DTAs between South Africa and other member countries of the SADC, clarifying the extent to which these DTAs were included in this study. This was followed by a critical comparison between the OECD Model and the DTAs that South Africa has concluded with Botswana, the DRC, Lesotho, Mauritius, Mozambique, Namibia, the Seychelles, Swaziland and Tanzania. The chapter illustrated the financial effect that the identified differences may theoretically have on corporate taxpayers in South Africa, using a scenario analysis method to clarify the effect.

The theoretical financial effect deduced from the hypothesis derived from the scenario analysis in Section 3.4 was used in Chapter 4 to underpinning these theoretical constructs in a real-world context.

The purpose of Chapter 4 was to clarify the research design and methodology adopted in this study to explore this phenomenon in a real-world context, using scenario analysis as a theoretical framework. The chapter explained the research design and the research methodology.

In Chapter 5, the data obtained from the survey questionnaire were analysed and interpreted. The chapter clarified the data analysis technique and then presented the results of the data analysis. The chapter set out conclusions on the data and analysis process. The findings presented in Chapter 5 indicate that a resident state company taxpayer will suffer double taxation or residual double taxation where the source state applies a withholding tax on the gross amount and the expenditure incurred in the

production of that income exceeds certain ratios to the gross amount where the resident state applies the ordinary credit method to eliminate double taxation. These results suggest that the theoretical scenario framework may help determine whether a company risks suffering residual double taxes.

The results from the research process presented in Chapter 5 were not based on a wide sample, but the data collected from one company confirming residual double taxation under certain ratios of expenditure incurred in producing the gross amount suggest the validity of the scenario framework in a wider context than this study.

The deviations between the OECD Model and South Africa's DTAs with other SADC countries have been identified in the study as allowing the source state to withhold tax on royalties and technical fees, which has a financial effect on South African corporate taxpayers, identified in this study as residual double taxation. Double taxation thus affects South African corporate taxpayers where the ratio of expenditure in producing the gross amount to the gross amount exceeds certain limits.

These deviations from the OECD Model are all provided for in the SADC Model. However, the SADC Model may also reflect what is contained in the DTAs between South Africa and Lesotho, Mauritius and Namibia, because these DTAs pre-date the SADC Draft Model (2001). The only of these deviations from the OECD Model provided for in the South African Model is the provision for taxing royalties in both the residence and the source state.

The study concludes that the financial effect on South African corporate taxpayers, in the form of residual double taxation, is not primarily a result of the deviations between the OECD Model and South Africa's DTAs with SADC countries, but is a result of the application of the ordinary credit method to eliminate double taxation provided for in Article 23B of the OECD Model (OECD, 2010:35).

The OECD Model, the UN Model, the SADC Model and the South African Model all provide for the ordinary credit method to eliminate double taxation. There may be a case for the full credit method to eliminate double taxation, particularly if the use of withholding

tax is to be considered as a tool in the protection of taxation at source. The burden of residual double taxation on the resident state taxpayer may be too heavy (unless there is a shift to the full credit method to eliminate double taxation) to consider more extensive use of withholding tax as a tool in the protection of taxation at source. A change to the full credit method for the elimination of double taxation as the preferred method may open the way for higher rates of withholding tax on more items in the protection of taxation at source.

Daurer (2014) concludes that a more radical source taxation-based model would be needed to oppose the OECD Model (Daurer, 2014:303). The challenge in finding an alternative is for African countries and their partners to find ways to end the vicious circle of aid dependence that shifts government accountability away from citizens towards donors. Instead, they need to start a virtuous circle of donors' working to make themselves redundant by supporting public resource mobilisation. She suggests that to agree on more source taxing rights in a tax treaty can contribute to such public resource mobilisation, as it ensures that income generated within a developing country, can actually be taxed there as well.

Daurer (2014) referring to De Goede and Dickinson's (2012:587-588) article 'The UN Model (2011)', which appeared in a Special Issue of the *Bulletin for International Tax*, suggesting that more research was needed on the issue of the difficult choices of economic development for developing countries between a large short-term tax (for example, by opting for relatively higher levels of withholding tax in the source country) and the longer-term effects of a lower tax level.

Daurer (2014) refers to Benson, *New York University Law Review*, Volume 38 (2010:43). Benson proposes the use of the international tax system to meet relational distributors' duties and points out that the status quo falls short of considering any distributive justice arguments. The allocation rules of tax treaties would be a suitable instrument to distribute wealth across borders, but many modifications are required before they would meet this goal.

A more radical source taxation-based model advocated, (Daurer, 2014:303), requires reconsideration of the methods for elimination of double taxation to protect resident corporate taxpayers from double taxation. The full credit method for elimination of double taxation has a role to play herein. A more radical source taxation-base model may include withholding tax at source on more items and at higher tax rates leading to a more equitable distribution of taxing rights between resident and source states.

The differences between the OECD Model and the DTAs concluded by South Africa with other SADC countries is not the primary reason for resident state company taxpayers' suffering double taxation or residual double taxation where a source state applies a withholding tax on the gross amount, and the expenditure incurred in the production of that income exceeds certain ratios to the gross amount. The primary reason is the application of the ordinary credit method to eliminate double taxation. This is indicated by the hypotheses derived from the scenario analysis and was confirmed by the survey data. South Africa applies the ordinary credit method to eliminate double taxation in all DTAs.

The conclusion that the financial effect of double taxation or residual double taxation on South African company taxpayers is not directly as a result of the differences between the OECD Model and the DTAs concluded by South Africa with SADC countries is reached on the basis that residual double taxation may also manifest in the case of withholding tax on interest which is provided for in the OECD Model, where the ratio of expenditure incurred to produce the gross interest subject to withholding tax exceeds certain specific limits.

Residual double taxation suffered by South African corporate taxpayers is a result of South Africa's adopting the ordinary credit method to eliminate double taxation as contained in article 23B of the OECD Model in the DTAs concluded with SADC and other countries.

The principle in the UN Model that taxation of income from foreign capital should take into account expenses allocable to the earning of the income so that such income is taxed on a net basis (UN, 2011:ix), has not been given effect to in any of the DTAs concluded by South Africa with SADC countries, as withholding tax on interest, royalties and technical fees is levied on the gross amount. If this UN principle is applied, double taxation or residual double taxation does not depend on the ratio of expenditure to income, but rather

on the relative rate of tax in the resident state and the source state. If the rate of tax is higher in the source state than in the resident state, it will give rise to residual double taxation where double taxation is to be eliminated by the ordinary credit method.

6.3 CONTRIBUTION OF THE STUDY

This is the first extensive comparative study between the OECD Model (2010) on the one hand, and the South African Model, the SADC Model, the UN Model and DTAs which South Africa has negotiated with SADC countries on the other in order to explore the potential financial impact differences on the net income after tax of corporate taxpayers in South Africa.

6.4 LIMITATIONS OF THE STUDY

The survey questionnaire was sent to the Top 40 companies, by market capitalisation, listed on the JSE's FTSE/JSE SWIX Top 40 Index, but only four companies responded. This response rate is not deemed to have essentially affected the outcomes of this study, as the study was exploratory and the data from the limited responses supported the scenario framework.

6.5 FUTURE RESEARCH

This study was exploratory and the results from the research process were not based on a wide sample. The data collected confirmed residual double taxation under certain ratios of expenditure incurred in producing the gross amount. This does suggest the validity of the scenario framework in a wider context than this study. The general validity of the theory should be tested in future studies using a quantitative research method to enhance the general validity.

Future research is required to establish

- the fundamental reasons underlying the deviations;
- the most efficient method to eliminate double taxation for both the resident state and the resident state taxpayer;

- the most efficient way in which double taxation may be eliminated for a resident corporate taxpayer in an assessed loss position; and
- the design and use of withholding tax to protect taxation at source.

6.6 CONCLUDING REMARKS

In closing, it is perhaps fitting to refer to Heady (2002:12), who reported that OECD countries found that DTAs encourage large scale international trade and investment. DTAs protect countries' tax base and give investors some assurance that they will not have to be subjected to double taxation. This reassurance to investors remains useless while residual double taxation is a reality.

There may be a case for the interests of taxpayers to be represented in the organisations that set the standards for model tax conventions. The composition of the Committee on Fiscal Affairs of the OECD and the UN Committee of Experts on International Cooperation in Tax Matters may benefit from taxpayer representation. The celebration of the 50th anniversary of the OECD Model Tax Convention in Paris, September 2008, was one occasion where academia, consultants and taxpayers were invited to participate.

Almost a century ago, Stamp (1921:201) argued that taxation questions must be considered not only from the perspective of governments, but also – and this is equally important – from the perspective of taxpayers. Stamp's argument is supported by Brennan and Buchanan (1980:225), who emphasise that it is essential to introduce tax policies that take the taxpayers into account, an aspect often neglected by public economists.

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ANNEXURE 1: LITERATURE

1.1 INTRODUCTION

This extended analysis of the literature is useful to place the current study in context with the current status of the topic and domestic law in South Africa regulating the matters covered in this study. The following seminal texts are considered in this analysis:

- Olivier, L. & Honiball, M. 2011. *International Tax: A South African Perspective*. (5th ed.) (Section 1.2);
- De Koker, A. & Brincker, E. 2011. *Silke On International Tax* (Section 1.3);
- Daurer, V. 2014. *Tax Treaties and Developing Countries* (Section 1.4);
- Schwarz, J. 2011. *Schwarz on Tax Treaties* (2nd ed.) (Section 1.5);
- the *South African Income Tax Act, Act 58 of 1962, As Amended, effective 1 March 2014* (Section 1.6);
- the *South African Explanatory Memorandum on Taxation Laws Amendment Bill 2011* (Section 1.7);
- the *South African Revenue Services Interpretation Note 18 (Issue 2) March 2009 on Rebate or Deduction for Foreign Taxes on Income* (Section 1.8); and
- Kopits, G.F. 1976. Intra-firm royalties crossing frontiers and transfer pricing behaviour. *The Economic Journal*, Volume 86 pages 791-805 (Section 1.9).

1.2 OLIVIER AND HONIBALL (2011)

In the introduction to Olivier and Honiball's (2011) book, *International Tax: A South African Perspective*, a number of points relevant to this study are made.

The first point is that international tax law does not exist, as the right to tax is part of a state's sovereign power (Olivier & Honiball, 2011:1). The discussion then turns to the South African income tax rules applying to cross-border transactions, which give rise to the inherent risk of international double taxation (Olivier & Honiball, 2011:6). Double taxation

may refer to either juridical or economic double taxation. Juridical double taxation arises when the same income is taxed in the hands of the same taxpayer in two different countries. Economic double taxation refers to the same income being taxed in the hands of two different taxpayers.

Relief for juridical double taxation may be provided under domestic law and/or under a DTA. There are three methods of relief for double taxation under domestic law (Olivier & Honiball, 2011:6):

- the deduction method, where the resident taxpayer is allowed a tax deduction for the foreign taxes paid on foreign source income (this gives only partial relief, equal to the domestic tax rate on the deduction);
- the exemption method, where foreign source income is exempt from tax; and
- the credit method, where a resident taxpayer is allowed a credit for the foreign taxes paid on foreign source income.

The South African *Income Tax Act* (see Section 1.6 of the Annexure) provides for both the deduction and the credit method in section 6 *Quat*. The deduction and credit provided by section 6 *Quin* of the *Income Tax Act* is different, as it is in respect of foreign taxes paid on South African source income (Olivier & Honiball, 2011:6).

1.2.1 DTAs

Chapter 9 of Olivier and Honiball's book is devoted to an overview (Olivier & Honiball, 2011:268-296), and Chapter 10 to the interpretation of DTAs (Olivier & Honiball, 2011:297-319).

The initial discussion is on the history of Model Tax Conventions, noting that the OECD Model is significant and used most extensively (Olivier & Honiball, 2011:268-274). The other Model Tax Conventions referred to are the United Nations Model Tax Convention, also Model Tax Conventions of Mexico and London adopted in Mexico and London respectively at different times (Olivier & Honiball, 2011:269).

There is a South African Model Tax Convention (the South African Model), which is also discussed more extensively by Mazansky (2009) in his article “South African Treaty Network – Why is South Africa the meat in the sandwich?” in the *Bulletin for International Tax*, 48. In this article, Mazansky (2009) argues that it is appropriate for any country that embarks on treaty negotiations to have its own template as a starting point.

Key features of the South African Model are that

- interest is taxable in the beneficial recipients’ state of residence;
- there is no limitation on the rate of tax in the source country on dividends and royalties (however, a rate limitation is in fact imposed in many of the South Africa DTAs); and
- the provision of services gives rise to a permanent establishment if the period(s) in question exceed(s) 183 days.

The SADC Model has the following key features:

- the denial of a tax deduction on amounts paid by a permanent establishment to a head office in royalties and fees;
- both states have taxing rights on royalties through bilateral negotiations; and
- technical fees may be taxed in the state where they arise if the beneficial owner resides in the other state.

The OECD Model gives primary taxing rights to the source state: the country of residence exercises its residual taxing rights by giving relief for foreign taxes paid on the source basis. In essence, the OECD Model assumes that the source state has to justify its taxing rights. In the absence of such a justification, the residence state has the right to tax. Olivier and Honiball (2011:297) argue that in interpreting DTAs, the “Renvoi principle”, applies: unless terms are specifically defined, the meaning that they have under the domestic law of the contracting state is applied.

South African courts accept that the OECD Model Tax Convention Commentary may be used in interpreting DTAs, even though South Africa is not a member state of the OECD. The OECD Model Tax Convention Commentary thus probably forms part of South African customary international law on the basis of acceptance in South African case law (*opinion juris*) generally used as an interpretive aid for DTAs (*usus*).

1.2.2 Withholding tax

Chapter 12 of Olivier and Honiball's (2011) book is devoted to a general overview of withholding tax. They mention in passing that some countries, particularly certain African states, impose a withholding tax on management fees (Olivier & Honiball, 2011:358). Their table of "Treaty Withholding Rates" (Olivier & Honiball, 2011:360-361) covers dividends, interest and royalties, but not technical or management fees.

1.2.3 Tax relief

Unilateral tax relief and DTA tax relief is covered in Chapter 17 (Olivier & Honiball, 2011). Arnold and McIntyre (2002:32, cited in Olivier & Honiball, 2011:443) claim that the deduction method is the least generous method of granting tax relief, because it grants a deduction as if a foreign tax was a current expenditure. However, this is not necessarily true where the credit method is based on the extent to which the income is taxed in South Africa, the "ordinary credit method". Where the income is produced with high deductible expenses, or where the profit margin is low, the deduction method may yield more generous results than the credit method.

South Africa has in the past mainly adopted the ordinary credit method when negotiating its DTAs and currently only adopts this method. Unilateral tax relief is provided in South Africa through sections 6*Quat* and 6*Quin* of the *Income Tax Act* and provides for both the credit method and the deduction method.

1.2.4 Mutual agreement procedures

Mutual agreement procedures (MAPs) are covered in Chapter 18 of Olivier and Honiball's (2011) book. They argue that, although an important aim of DTAs is eliminating double taxation, the existence of double taxation or potential for double taxation is not a requirement for the use of MAPs. A taxpayer does not have to wait for an assessment, as in domestic law, to make use of MAPs. MAPs may be initiated once a taxpayer is certain

that a contracting state will apply a DTA in a specific way, without a formal assessment. MAPs are not subject to first fully exhausting domestic remedies.

Mutual Agreement Procedures and the Role of the Taxpayer (Runge 2002: International Bureau for Fiscal Documentation 18 at 17, cited in Olivier and Honiball (2011: 475) on the MAP process:

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 taxpayer puts the MAP in motion but has no automatic right to appear before the authorities to state his or her case, or to be represented. However, the OECD makes the point that it is desirable that a taxpayer should have the right to make representations and be assisted by counsel.

1.2.5 Non-discrimination

Non-discrimination is also covered in Chapter 18 (Olivier & Honiball, 2011).

The important point made is that the OECD Model article on non-discrimination does not provide that non-nationals cannot be treated differently to nationals, only that the taxation on non-nationals cannot be more burdensome than that of nationals (Olivier & Honiball, 2011:486). It does not amount to discrimination if the differentiation does not amount to non-nationals' carrying a higher tax burden than nationals. Withholding tax may be imposed on non-nationals and nationals who are not subjected to withholding tax, as long as the effect of the withholding tax is not that non-nationals pay tax at a higher rate than nationals when they are assessed.

This view stands in contrast to the OECD Model Commentary (OECD, 2012:333) that the non-discrimination article in a DTA must be read in the context of the other articles. This

implies that measures authorised by other articles, such as withholding tax, cannot be in violation of the non-discrimination article.

This view should be compared to the judgement in *ITC 1544 54 SATC 456* (cited in Olivier & Honiball, 2011:491) that the non-discrimination provision was intended to override the specific preceding articles of the DTA that grant specific taxing rights. The court applied the principle that a special provision appearing later in the DTA should, in cases of conflict, prevail over articles of a general nature. Olivier and Honiball (2011) express the opinion that it is doubtful whether the non-discrimination article in a DTA can be regarded as more specific. As a result, it is difficult to understand the reasoning that the more specific provision overrides the more general provision.

1.3 DE KOKER AND BRINCKER (2011)

1.3.1 General

In the introduction to De Koker and Brincker's (2011) book, *Silke on International Tax*, a number of points relevant to this study are made. These are discussed briefly below.

A DTA is an arrangement between contracting states and international taxpayers. DTAs are more: they also constitute governing law between the domestic rights of international taxpayers and the state. The most fundamental doctrine is *pacta sunt servanda*, that every DTA in force is binding upon the parties and must be performed in good faith. The good faith basis implies that a party cannot invoke the provisions of its domestic law as a justification for a failure to perform.

The OECD Model favours capital-exporting countries over capital-importing countries, acting as a mechanism to transfer tax revenue from a developing country to developed countries by restricting the tax revenue at source in the developing country. The UN Model is more acceptable for developing countries, because it imposes fewer restrictions on the fiscal jurisdiction of the source country.

South Africa has to a significant extent adopted the OECD Model, and has generally only made minor adjustments, although South Africa is not a member state of the OECD. Consequently, the commentary to the OECD Model has persuasive force in the interpretation of DTAs concluded by South Africa.

1.3.2 Withholding tax

Withholding tax is covered in Chapter 5 (De Koker & Brincker, 2011), but the discussion is limited to withholding taxes in terms of the *Income Tax Act* on payments originating in South Africa.

1.3.3 Payment of international tax obligations

The payment of international tax obligations is covered in Chapter 11 (De Koker & Brincker, 2011), dealing with the right to recover based on a request from the other state. This aspect is not relevant to this study.

1.3.4 DTAs

The conclusion and force of DTAs is discussed in Chapter 12 (De Koker & Brincker, 2011) and the nature of DTAs concluded by South Africa in Chapter 13 (De Koker & Brincker, 2011).

De Koker and Brincker (2011) highlight the distinction between “may” and “shall”. If “may” is used, both states can tax, whereas if “shall” is used, only one state will tax.

The question as to whether a DTA can impose tax is discussed. De Koker and Brincker (2011) conclude that, in principle, a DTA does not give any right to tax where the treaty partner state does not tax, even though it has been allocated the right to tax. Baker (2005, cited in De Koker & Brincker, 2011) indicates that although this has not yet been clarified, the better view is that a DTA does not provide a basis for a higher tax charge unless the application of domestic law results in the higher tax charge.

The nature of DTAs concluded by South Africa is discussed in Chapter 13 (De Koker & Brincker, 2011). South Africa has formulated a model DTA that resembles the OECD Model closely. The instances where the South African Model differs from the OECD Model are largely consistent with those instances where South Africa has reserved its position in terms of the Commentary to the OECD Model.

The model DTA prepared for SADC is largely based on the South African Model, but has not found much favour with SADC countries. There is a general impression that countries would prefer to protect their own tax base, especially in respect of interest, royalties, technical fees and dividends.

1.3.5 Elimination of international double tax

The elimination and avoidance of international double tax is discussed in Chapter 36 (De Koker & Brincker, 2011). The first significant point made is that avoidance of international double tax is at the heart of the international dimension of most modern income tax regimes and that it is all about ensuring that international double tax is prevented, in the broadest sense.

Some of the earliest work on elimination of double tax was undertaken by the League of Nations in the 1920s. South Africa introduced income tax by 1914, but it was only in 1939 that the country concluded its first comprehensive DTA, with Southern Rhodesia (De Koker & Brincker, 2011). After concluding a DTA with the United Kingdom in 1946, a number of other DTAs were concluded, at first mainly with commonwealth countries (De Koker & Brincker, 2011). Since the end of World War II, the removal of international trade barriers has become a central objective (De Koker & Brincker, 2011). International double tax is such a barrier to cross-border trade, as it encourages taxpayers to restrict investment and trade to their own jurisdiction, where they are safer from being taxed twice on the same income.

South Africa has the largest DTA network in Africa and compares favourably with its trading partners. The most significant unilateral relief for international juridical double tax for South African tax residents is provided under section 6*Quat* of the *Income Tax Act* (De

Koker & Brincker, 2011). The relief takes the form of both foreign tax credit and foreign tax deduction methods. Parallel bilateral relief is provided to South African tax residents under DTAs which is confined to either the foreign income exemption or more commonly the foreign tax credit method (De Koker & Brincker, 2011).

Specific further relief from international juridical double tax under the *Income Tax Act* is available to South African tax residents in respect of the withholding tax on royalties in terms of section 35 of the *Income Tax Act*, exempt from income tax under section 10(1)(l) of the *Income Tax Act* (De Koker & Brincker, 2011).

De Koker and Brincker (2011) point out that there is an absence of significant case law in South Africa dealing with the applicable statutes or the DTAs in this area. Double tax avoidance is a complicated area of tax, requiring an understanding of the domestic laws of a foreign country (De Koker & Brincker, 2011).

1.3.6 Non-discrimination

Chapter 37 is devoted to non-discrimination (De Koker & Brincker, 2011). The authors state that in terms of the OECD Commentary on the OECD Model, the non-discrimination article must be read in the context of the other articles in the DTA (De Koker & Brincker, 2011).

Discrimination may occur if an enterprise is not entitled to deduct a payment to a non-resident in circumstances where the enterprise would have been entitled to the deduction if the payment had been made to a resident of its own state. The Commentary on the OECD Model indicates that a non-discrimination provision prohibits additional information requirements in respect of payments made to non-residents.

1.3.7 Mutual agreement procedures

Mutual agreement procedures are discussed in Chapter 38 (De Koker & Brincker, 2011). MAPs allow interaction with the aim of resolving international tax disputes involving cases

of double tax, and inconsistencies in the interpretation and application of a DTA between contracting states.

OECD countries found that the number of cross-border disputes and the complexity of the cases involved has risen and unresolved issues have become more common according to the OECD report *Improving the Process for Resolving International Tax Disputes*, which was released for comment on 27 July 2004 (cited in De Koker & Brincker, 2011). Unresolved cases usually lead to double tax, which could ultimately be an impediment to cross-border activity.

According to Article 25 (OECD, 2010:36-37), a request for assistance under MAP is allowed irrespective of remedies provided by the domestic law of a state. Taxpayers may therefore request MAP assistance even if they have raised an objection or appeal under domestic law. The request for MAP must be to the competent authority of the resident state. Competent authorities under MAP may communicate with each other directly and are not obliged to use diplomatic channels for this purpose.

1.3.8 Technical fees

Technical fees are covered in Chapter 45 (De Koker & Brincker, 2011). DTAs concluded by South Africa sometimes include an article dealing with tax on technical fees similar to that on taxing of royalties. The source state has limited taxing rights, whereas the resident state has full taxing rights. Generally, the rate of tax allowed to the source state is equal to that applies to royalties.

South Africa has DTAs with articles on technical fees at 10% on gross fees with the following SADC countries:

- Botswana (South Africa, 2004);
- Lesotho (South Africa, 1997a); and
- Swaziland (South Africa, 2005).

Some SADC countries charge withholding tax on technical fees arising in their country even where the source of such fees is not within their state. As a result, South Africa has

enacted section 6^{Quin} of the *Income Tax Act* to provide tax credit for foreign tax on South African-sourced income.

1.4 DAURER (2014)

Daurer's book *Tax Treaties and Developing Countries* (2014) is based on her doctoral thesis, produced while Daurer was a researcher at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business.

Daurer (2014) investigates the DTAs of developing countries in East and Southern Africa, but excludes South African DTAs on the basis of the argument that South Africa, a member of BRICS, is an economy in transition or newly industrialised economy, and no longer qualifies as a developing country in the Southern African context. In SADC and the Common Market for Eastern and Southern Africa Model (COMESA), the only country which in relation to all the other countries will probably be a capital exporter is South Africa (Daurer, 2014:122).

Daurer's (2014) study investigates whether or not the UN Model, which is designated to serve the interests of developing countries, is frequently used by a sample group of African countries in order to show how important the UN Model is in the treaty practices of the poorest countries in the world (Daurer, 2014:3). Daurer (2014:4) looks at how source and residence taxation can be justified and which of the two concepts should be given preference in the context of developing countries.

She criticises the UN Model because it does not go far enough and is not radical enough for developing countries (Daurer, 2014:303). The UN Model taxes business profits if the business is through a permanent establishment, but also taxes similar business that is not through the permanent establishment, which it refers to as the "limited force of attraction rule". This provision counteracts efforts of an enterprise to circumvent taxation through a permanent establishment by direct sales (Daurer, 2014:66).

Daurer (2014:10) observes that it is the prevailing view that tax treaties are indispensable to the elimination of double taxation. In this regard, she cites Dagon's article 'The tax

treaties myth', which was published in the *New York University Journal of International Law and Policy* (Dagon, 1999-2000:939, cited in Daurer, 2014:10). However, she observes that the same effect can also be achieved by unilateral measures (Daurer, 2014:10).

It may be argued that unilateral measures can lead to losses of revenue for the country that grants unilateral relief from double taxation, because that country has no guarantee that the other country will grant a similar relief, according to Jacobs, in his book *Internationale Unternehmensbesteuerung* (2007:37, cited in Daurer, 2014:12). Daurer (2014:22-23) also refers to the article by Easson, *Do we still need tax treaties?* in the *Bulletin for International Tax* (2000:623-624), which argues that true reciprocity is usually not achieved, because the source state gives up more than the resident state.

Taxing income depends on the prerequisite of having a genuine link, implying that not just any random transaction or activity can be taxed by a state but only such with a factual connection to that state (Daurer, 2014:14).

Daurer (2014:15) observes that it is a global standard or international consensus that most countries tax both the income of residents and the income of non-residents, but that the taxable income of non-residents is limited to domestically sourced income. This implies worldwide taxation combined with the territoriality principle, characterised by the source and residence principles of taxation.

The process by which the SADC Draft Model was developed included reviewing the DTAs of the member states. Hence, the SADC Draft Model includes the articles common to or most common in the existing DTAs (Daurer, 2014:120). COMESA basically adopted the provisions of the SADC Model (Daurer, 2014:122).

Daurer (2014:300) concludes that, given tax treaties' function of eliminating tax avoidance, it might be financially more reasonable for poor countries to introduce only unilateral measures. A tax treaty also has the function of allocating taxing rights between the two contracting states, which is the first step that has to be taken before the elimination of double taxation by credit or exemption is possible (Daurer, 2014:300).

She concludes that a more radical source taxation-based model would be needed to oppose the OECD Model (Daurer, 2014:303). The challenge in finding an alternative is for African countries and their partners to find ways to end the vicious circle of aid dependence that shifts government accountability away from citizens towards donors. Instead, they need to start a virtuous circle of donors' working to make themselves redundant by supporting public resource mobilisation". Daurer (2014:26) suggests that to agree on more source taxing rights in a tax treaty can contribute to such public resource mobilisation, as it ensures that income generated within a developing country, can actually be taxed there as well. Daurer (2014) cites Pistone's contribution *Tax treaties with developing countries: a plea for new allocation rules and a combined legal and economic approach* in a book edited by Lang, Pistone, Schuch, Staringer and Zayer (2010:413 - 439, cited in Daurer, 2014:27), which argues that the missing link in that line of reasoning is that without a tax treaty and its OECD-based allocation rules, developing countries could be "lord[s] of their own financial destinies". Daurer (2014:27) quotes Pistone (2010:439), who suggests that countries could levy source taxes at a desirable level, and the foreign tax credit system or other unilateral measures implemented by most industrialised countries would then join in to avoid double taxation.

Daurer (2014:28) also refers to De Goede and Dickinson's (2012:587-588) article 'The UN Model (2011)', which appeared in a Special Issue of the *Bulletin for International Tax*. At the time, they suggested that more research was needed on the issue of the difficult choices of economic development for developing countries between a large short-term tax (for example, by opting for relatively higher levels of withholding tax in the source country) and the longer-term effects of a lower tax level. They claim that investing in a country always includes the burden of thinking about tax, handing in a tax return or applying for reimbursement of source taxes – it is part of the deal. They conclude that having a tax treaty with a 5% withholding tax, as in the OECD Model, is just as much a burden as having a tax treaty with a 15% withholding tax rate.

Daurer (2014:26) refers to Benshalom, *New York University Law Review, Volume 38* 2010:43). Benson proposes the use of the international tax system to meet relational distributors' duties and points out that the status quo falls short of considering any distributive justice arguments. The allocation rules of tax treaties would be a suitable

instrument to distribute wealth across borders, but many modifications are required before they would meet this goal.

Pistone's (2010:413, cited in Daurer, 2014:27) book *Tax treaties with developing countries: a plea for new allocation rules and a combined legal and economic approach* argues for allocating taxing rights to the country which has the strongest connection to the source of the income. In the *eJournal of Tax Research*, Brooks (2007:169, cited in Daurer 2014:26) suggests levying more taxes on royalties, focusing on this type of income, which Daurer considers the best example for showing how unfair the allocation of taxing rights are.

1.5 SCHWARZ (2011)

Schwarz deals with the UK's position on tax treaties.

1.5.1 Treaty versus unilateral relief

Schwarz (2011:276) points out that unilateral relief under domestic law is a residual relief and not an additional relief. If a DTA contains an express provision that credit for foreign tax is not to be given under the DTA under specified cases or circumstances, then credit may not be given either by treaty or by way of unilateral relief.

1.5.2 Tax sparing

Tax sparing (Schwarz, 2011:284) occurs in cases where, because of tax concessions to attract investment, the benefit of tax concessions is lost if the resident country does not give credit for the tax saved by the tax concessions as if the tax was paid.

1.5.3 Non-discrimination

Only the host states are prohibited from discrimination against foreigners in certain respects (Schwarz, 2011:288). The OECD Model (2010) advocates an exemption to the equal treatment rule in respect of personal allowances and relief.

1.5.4 Mutual agreement procedures

MAPs are covered in Chapter 18 (Schwarz, 2011), notwithstanding the remedies provided by the domestic laws of contracting states. It is an additional process available to taxpayers, and is not a substitute for the appeal process (Schwarz, 2011:366). MAPs require contracting states to endeavour to resolve the difficulty, rather than to actually resolve them. MAPs are a government to government activity, and taxpayers have no legal entitlement to participate in or observe the negotiations.

1.6 SOUTH AFRICAN *INCOME TAX ACT, ACT 58 OF 1962 AS AMENDED, EFFECTIVE 1 MARCH 2014*

1.6.1 Section 6*Quat* and 6*Quin*

Sections 6*Quat* and 6*Quin* regulate a rebate or deduction in respect of foreign taxes on income. Section 6*Quat* refers to foreign taxes on income from a foreign source, and section 6*Quin* covers foreign taxes on income from a South African source.

1.6.2 Section 108

This section provides the authority to enter into DTAs and provides that DTAs have the effect as if they were enacted in the South African *Income Tax Act, Act 58 of 1962*.

1.7 THE SOUTH AFRICAN *EXPLANATORY MEMORANDUM ON TAXATION LAWS AMENDMENT BILL 2011*

The provisions introducing the rebate or deduction in respect of foreign withholding tax on South African-sourced income into South African legislation were introduced by means of the *Taxation Laws Amendment Act, Act 24 of 2011* (South Africa, 2011b). The *Explanatory Memorandum* (South Africa, 2011a) indicates that African countries impose withholding tax on services rendered in South Africa where the payments are funded from the African country, despite the fact that taxing in this manner on South African source income by a foreign country is contrary to the DTA. While the South African position is correct in law,

the practical implications are adverse to the South African objective of becoming a regional financial centre.

1.8 SOUTH AFRICAN REVENUE SERVICES INTERPRETATION NOTE 18 (2009)

The interpretation note (South Africa, 2009a) explains the scope, interpretation and application of section 6Quat of the *Income Tax Act*. Taxpayers may choose between the application of domestic law, section 6Quat of the *Income Tax Act* or the relief provided for in a DTA, where the DTA provides that the relief is subject to the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa.

The advantage of domestic law over the DTA provision is that the relief under domestic law allows a carry-forward of tax credit that is not fully utilised in the current tax year, and the deduction method of eliminating double taxation is available as an alternative method.

The principles in this interpretation note apply equally, to the extent applicable, to section 6Quin of the *Income Tax Act*. Section 6Quin of the *Income Tax Act* was enacted after the publication of this interpretation note. The Interpretation Note is in the process of being revised (Interpretation Note 18 issue 3).

1.9 KOPITS (1976)

Kopits (1976) in his article, “Intra-firm royalties crossing frontiers and transfer pricing behaviour” in *The Economic Journal Volume 86*, argues that royalty payments crossing frontiers deprive the revenue authority of the country from which the payment is made of tax because of the tax deduction afforded to the taxpayer making the payment. He points out that several Latin American host countries no longer allow any tax deduction to taxpayers making the payment where the payment is made to a related party in a foreign country. This is a method of protecting the tax base.

ANNEXURE 2: QUESTIONNAIRE

QUESTIONNAIRE on WITHHOLDING TAX on INTEREST, ROYALTIES, TECHNICAL FEES, OTHER INCOME and MUTUAL AGREEMENT PROCEDURES

It is not necessary to identify the company, however, it will be of assistance if we could clarify information if necessary. Companies will not be identifiable in any way in the study.

Name of Company

Industrial/commercial sector

Name and contact details of person providing the information

Name

e-mail

telephone

I am authorised by the company to participate in this study and I have signed the informed consent (please tick)

What is the most recent year of tax assessment of the company?

2013

Definitions:

Royalties:

The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films and films, tapes or discs for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience. (emphasis added).

Source: South African / Botswana DTA Article 12 paragraph 3.

Technical Fees:

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

Source: South African / Botswana DTA Article 20 paragraph 3.

Other Income:

The term is not defined, however the following definition may be deduced. Items of income of a resident of a contracting state not dealt with in the foregoing articles of the convention.

Source: South African / Botswana DTA Article 21 paragraph 1.

QUESTIONNAIRE on WITHHOLDING TAX on INTEREST, ROYALTIES, TECHNICAL FEES, OTHER INCOME and MUTUAL AGREEMENT PROCEDURES

It is not necessary to identify the company, however, it will be of assistance if we could clarify information if necessary. Companies will not be identifiable in any way in the study.

Name of Company

Industrial/commercial sector

Name and contact details of person providing the information

Name

e-mail

telephone

I am authorised by the company to participate in this study and I have signed the informed consent (please tick)

What is the most recent year of tax assessment of the company?

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Definitions:

Royalties:

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Source: South African / Botswana DTA Article 12 paragraph 3.

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Other Income:

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Source: South African / Botswana DTA Article 21 paragraph 1.

QUESTIONNAIRE on WITHHOLDING TAX on INTEREST, ROYALTIES, TECHNICAL FEES, OTHER INCOME and MUTUAL AGREEMENT PROCEDURES

page 2.

1. Did the company receive Interest in the most recent year of assessment from :

Botswana	<input type="text" value="Yes"/>
DRC	<input type="text" value="Select"/>
Lesotho	<input type="text" value="Yes"/>
Mauritius	<input type="text" value="Select"/>
Mozambique	<input type="text" value="No"/>
Namibia	<input type="text" value="Yes"/>
Seychelles	<input type="text" value="Select"/>
Swaziland	<input type="text" value="Select"/>
Tanzania	<input type="text" value="Select"/>

Please complete only the darker shaded cells in the table below

INTEREST		INTEREST RECEIVED	EXPENDITURE DIRECTLY INCURRED	WITHHOLDING TAX	SA TAX CREDIT
		R'000	R'000	R'000	R'000
Botswana	2				
DRC	1				
Lesotho	2				
Mauritius	1				
Mozambique	3				
Namibia	2				
Seychelles	1				
Swaziland	1				
Tanzania	1				

2. Did the company receive Royalties in the most recent year of assessment from :

Botswana	<input type="text" value="Yes"/>
DRC	<input type="text" value="No"/>
Lesotho	<input type="text" value="No"/>
Mozambique	<input type="text" value="No"/>
Namibia	<input type="text" value="No"/>
Swaziland	<input type="text" value="Yes"/>
Tanzania	<input type="text" value="Yes"/>

Please complete only the darker shaded cells in the table below

ROYALTIES		ROYALTIES RECEIVED	EXPENDITURE DIRECTLY INCURRED	WITHHOLDING TAX	SA TAX CREDIT
		R'000	R'000	R'000	R'000
Botswana	2				
DRC	3				
Lesotho	3				
Mozambique	3				
Namibia	3				
Swaziland	2				
Tanzania	2				

QUESTIONNAIRE on WITHHOLDING TAX on INTEREST, ROYALTIES, TECHNICAL FEES, OTHER INCOME and MUTUAL AGREEMENT PROCEDURES

page 3.

3. Did the company receive Technical Fees in the most recent year of assessment from :

Botswana	<input type="text" value="No"/>	▼
Lesotho	<input type="text" value="Yes"/>	▼
Swaziland	<input type="text" value="No"/>	▼

Please complete only the darker shaded cells in the table below

TECHNICAL FEES		TECHNICAL FEES RECEIVED	EXPENDITURE DIRECTLY INCURRED	WITHHOLDING TAX	SA TAX CREDIT
		R'000	R'000	R'000	R'000
Botswana	3				
Lesotho	2				
Swaziland	3				

4. Did the company receive Other Income in the most recent year of assessment from :

Botswana	<input type="text" value="Yes"/>	▼
DRC	<input type="text" value="Yes"/>	▼
Mozambique	<input type="text" value="No"/>	▼
Namibia	<input type="text" value="Yes"/>	▼
Seychelles	<input type="text" value="Yes"/>	▼
Swaziland	<input type="text" value="Yes"/>	▼
Tanzania	<input type="text" value="Select"/>	▼

Please complete only the darker shaded cells in the table below

OTHER INCOME		OTHER INCOME	EXPENDITURE DIRECTLY INCURRED	WITHHOLDING TAX	SA TAX CREDIT
		R'000	R'000	R'000	R'000
Botswana	2				
DRC	2				
Mozambique	3				
Namibia	2				
Seychelles	2				
Swaziland	2				
Tanzania	1				

QUESTIONNAIRE on WITHHOLDING TAX on INTEREST, ROYALTIES, TECHNICAL FEES, OTHER INCOME and MUTUAL AGREEMENT PROCEDURES

page 4.

5. Has the company made use of the Mutual Agreement Procedures (MAP'S) provided for in article 23 of the South Africa Model Tax Convention, also article 25 of the OECD Model Tax Convention?

Select ▼

Was the Mutual Agreement Procedures used in respect of matters arising from SADC countries:

Was the Mutual Agreement Procedures satisfactory?

Botswana	No ▼	Botswana	Select ▼
DRC	No ▼	DRC	Select ▼
Lesotho	No ▼	Lesotho	Select ▼
Mauritius	No ▼	Mauritius	Select ▼
Mozambique	No ▼	Mozambique	Select ▼
Namibia	No ▼	Namibia	Select ▼
Seychelles	Yes ▼	Seychelles	Select ▼
Swaziland	Yes ▼	Swaziland	Select ▼
Tanzania	Yes ▼	Tanzania	Select ▼

Any additional details would be appreciated:

Save File

Print

*Email to Frans
Krause*

krausefa@telkomsa.net

ANNEXURE 3: INFORMED CONSENT AND FACULTY APPROVAL



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

Faculty of Economic and
Management Sciences

Informed consent for participation in an academic research study

Department of Taxation

TITLE OF THE STUDY: A COMPARATIVE STUDY OF DOUBLE TAX AGREEMENTS IN A SOUTHERN AFRICAN CONTEXT

Research conducted by:

Mr F.A. Krause (11360918)

Tel 082 578 3627

Dear Respondent

You are invited to participate in an academic research study conducted by Frans Krause, a Master's student at the Department Taxation at the University of Pretoria.

The purpose of the study is to determine the tax cost of withholding tax on royalties and technical fees to the parties.

Please note the following:

- Your participation in this study is very important to us. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- The results of the study will be used for academic purposes only and may be published in an academic journal. We will provide you with a summary of our findings on request.
- Please contact my supervisor, Prof. T.L. Steyn, at Tel 012 420 3408, or e-mail theuns.steyn@up.ac.za, if you have any questions or comments regarding the study.

Please sign the form to indicate that

- you have read and understand the information provided above; and
- you give your consent to participate in the study on a voluntary basis.

Respondent's signature

Date



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

FACULTY OF ECONOMIC AND
MANAGEMENT SCIENCES

RESEARCH ETHICS COMMITTEE

Tel: +27 12 420 4102

E-mail: berendien.lubbe@up.ac.za

18 March 2014

Strictly confidential

Prof TL Steyn
Department of Taxation

Dear Professor Steyn

Project: A comparative study of double tax agreements in a Southern African context
Researcher: FA Krause
Student No: 11360918
Promoter: Prof TL Steyn
Department: Taxation

Thank you for the application you submitted to the Committee for Research Ethics, Faculty of Economic and Management Sciences.

I have pleasure in informing you that the above study was approved on an *ad hoc* basis on 18 March 2014. The approval is subject to the candidate abiding by the principles and parameters set out in the application and research proposal in the actual execution of the research.

The approval does not imply that the researcher, student or lecturer is relieved of any accountability in terms of the Codes of Research Ethics of the University of Pretoria if action is taken beyond the approved proposal.

The Committee requests that you convey this approval to the researcher.

We wish you success with the project.

Sincerely


PROF BA LUBBE
CHAIR: COMMITTEE FOR RESEARCH ETHICS

cc: Prof M Stiglingh
Student Administration

Members: Prof BA Lubbe (Chair); Prof RS Rensburg (Deputy Chair); Prof HC Brand; Dr CC Desja-Dice; Prof JH Hoai; Prof JF Kirsten; Dr MC Mathaa; Prof JE Myburgh; Dr SG Ntombi; Ms K Hani; Prof C Theron; Prof R van Eysen; Prof SR van Jaarsveld, Dr M Wess
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