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SOUTH AFRICA'S POSITION ON AND REGULATION OF TREATY SHOPPING

By

TEGAN NATALIE HARING

u17007730

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SUPERVISED BY KHODANI SENGWANE

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Declaration

I, Tegan Natalie Haring, hereby declare that the work contained in this dissertation is my own original, unaided work, which is been submitted in partial fulfilment of the prerequisites for the degree of Master's in Tax Law at the University of Pretoria. It has never been previously, in its entirety or in part, and submitted at any University for a degree or examination. Where secondary material is used, this has been carefully acknowledged and referenced following the University of Pretoria requirements. I am aware of the University of Pretoria policy and implications regarding plagiarism.

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I would like to express my sincere gratitude to my supervisor who made this work possible.

I would also like to acknowledge my friends and family, in particular my parents, for their unwavering support. I would not have made it to the end without your unwavering belief in me and constant motivation. It means more to me than you will ever know.

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List of abbreviations

APA - Advance Pricing Agreement

BEPS - Base Erosion and Profit Shifting

CFC - Controlled Foreign Company

DTA - Double Taxation Agreement

GAAR - General Anti-Avoidance Rules

LOB – Limitation of Benefits

MAP - Mutual Agreement Procedure

MLI - Multilateral Instrument

MNE - Multinational Enterprise

OECD - Organisation for Economic Co-operation and Development

PPT - Principal purposes test

SAAR - Specific Anti-Avoidance Rules

SARS - South African Revenue Services

ITA - Income Tax Act

TAA - Tax Administration Act

UN – United Nations

US – United States

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Chapter 1: General Introduction[N1]

1.1 Background and Topic Introduction

Recent years have seen a significant increase in the restructuring of multinational enterprises[1] ("MNE"), mainly for strategic and financial reasons, such as accessing beneficial tax regimes through Double Taxation Agreements ("DTAs"). DTAs are bilateral agreements[2] designed to prevent double taxation and promote cross-border trade and investment, with between 3,000 and 4,000 active treaties in force worldwide today.[3] However, this widespread network of DTAs has inadvertently created opportunities for tax avoidance known as treaty shopping, where taxpayers seek to exploit favourable DTA provisions.[4]

Treaty shopping is a practice where taxpayers strategically structure their investments or business operations in order to exploit the advantageous provisions of DTAs. By directing investments or transactions through intermediary jurisdictions with favourable tax treaties, taxpayers can access significant tax benefits.[5] Treaty shopping offers several potential advantages for taxpayers.[6] It can result in reduced or even non-existent withholding taxes on specific types of income, such as dividends, interest, or royalties, leading to higher after-tax returns for investors.[7] Additionally, it may provide access to lower tax rates on income or capital gains compared to the tax rates in the MNE's state of registration. When

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[1] A Multinational enterprise is an enterprise producing goods or delivering services in more than one country; See Kogut & Reuben "Multinational Corporations" in *International Encyclopedia of the Social & Behavioral Sciences* (2015) 1.
[2] "*Bilateral tax agreements, pertain to the tax relationship between two countries and allow for flexible negotiations. In contrast, multilateral tax agreements involve multiple countries and address tax issues collectively, utilising standardized rules and procedures*." See Avi-Yonah and Lempert (2023) "The Historical Origins of the Multilateral Tax Convention" *Law & Economics Working Papers* 4.
[3] Arel-Bundock "The Unintended Consequences of Bilateralism: Treaty Shopping and International Tax Policy" (2017) *Cambridge University Press* 352.
[4] Arel-Bundock (2017) *Cambridge University Press* 352.
[5] As above.
[6] Leduc and Michielse "Are Tax Treaties Worth It for Developing Economies?" in *Corporate Income Taxes under Pressure* (2021) *IMF* 17.
[7] Leduc and Michielse (2021) 17.

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structured in compliance with relevant laws and regulations, treaty shopping can serve as a legally valid means to optimise a taxpayer's liability.[8]

To qualify for DTA benefits, entities must be residents of a contracting state,[9] which involves factors like legal registration, principal place of business, and economic ties.[10] There are many arrangements through which a person who is not a resident of a contracting state may attempt to obtain benefits that a tax treaty grants to a resident of that state via treaty shopping structures.[11] These arrangements involve structuring an entities' financial affairs or business operations through intermediaries or entities located in a treaty state.[12] By doing so, they aim to create a link to that treaty state and take advantage of the tax treaty provisions, even if they are not genuine residents of that state.[13]

While treaty shopping is a technically legal tax avoidance strategy,[14] it raises various concerns related to equity, ethics, and the intended purpose of tax treaties.[15] As a result, it is often considered to be an abuse of treaty provisions and deemed unacceptable by governments, international organisations, and the general public; this perception has led to efforts to mitigate treaty shopping through legal and regulatory measures.[16]

This research analyses South Africa's regulation of treaty shopping through legislation, common law, adherence with OECD recommendations[17] and a comparison with the US

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[8] Leduc and Michielse (2021) 17.
[9] Article 1 of the OECD Model Tax Convention on Income and on Capital (2017).
[10] OECD "Articles of the Model Convention with Respect to Taxes on Income and Capital" 6.
[11] OECD "BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances" (2014) 4.
[12] OECD "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" (2010) 8.
[13] As above.
[14] Tax avoidance refers to the legal method of reducing a taxpayer's liability by using the provisions of the fiscal legislation to his or her advantage; see Croome *et al Tax law: An Introduction* (2013) 487. "*This should be distinguished from tax evasion, which is the reduction of a taxpayer's tax liability by illegal means such as the non-declaration of income that is properly subject to tax or by claiming deduction to which the taxpayer is not entitled*"
[15] Thrall *Spillover Effects in International Law: Evidence from Tax Planning* (PhD thesis 2021 University of Texas) 1.
[16] Thrall 3.
[17] The OECD serves as a distinctive platform where 37 democratic nations with market-oriented economies work together to establish policy standards aimed at fostering sustainable economic growth; See OECD "About the OECD" https://www.oecd.org/about/ (accessed 20 April 2023).

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approach to tacking treaty shopping practices such as the implementation of the US model tax treaty.[18]

1.2 Research Problem

The research problem addressed in this thesis revolves around the impact of treaty shopping on the South African tax base, particularly concerning MNEs. Corporate tax revenue generated from MNEs constitutes a significant portion of South Africa's tax base, which is vital for sustaining the state's progress as a developing nation.[19] However, treaty shopping, a practice where MNEs exploit tax treaties to minimise tax liabilities, poses a threat to this revenue stream.[20] Therefore, the primary research question focuses on assessing the extent of treaty shopping in South Africa and evaluating whether existing regulations and legislation adequately addresses this issue.

To tackle this research problem, this study aims to analyse various aspects, including the prevalence of treaty shopping among MNEs, the sophistication of their tax avoidance strategies, and the effectiveness of regulatory oversight in detecting and preventing such practices. Additionally, the sufficiency of existing regulatory legislation is evaluated, considering factors such as the clarity and comprehensiveness of tax laws, the capacity and diligence of tax authorities, and the availability of legal remedies to combat treaty abuse.

Ultimately, this research seeks to provide insights into the adequacy of regulatory measures in countering tax base erosion caused by treaty shopping in South Africa. By prioritising compliance with international best standards of taxation, South Africa can ensure the protection of its national tax base, which is crucial for its continued development and welfare. Thus, addressing this research problem is essential for fostering an effective international tax system and promoting the state's sustainable growth.

[18] US Model Income Tax Convention 2016.
[19] SARS "Tax Statistics 2023 Highlights" https://www.sars.gov.za/wp-content/uploads/2023-Tax-Statistics-Main-Publication-compressed.pdf (accessed 23 March 2024).
[20] Oguttu "Tax Base Erosion and Profit Shifting in Africa - Part 1: What Should Africa's Response Be to the OECD BEPS Action Plan" 2015 *Comparative and International Law Journal of Southern Africa* 12.

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1.3 Research Questions

1.3.1 What is treaty shopping and how prevalent is the issue of treaty shopping in South Africa?

1.3.2 How does South Africa regulate treaty shopping in its domestic law?

1.3.3 How does South Africa use DTA's to regulate treaty shopping?

1.3.4 What is the stance of the US regarding treaty shopping, and are there any lessons for South Africa to learn from the US?

1.3.5 How can South Africa improve its position in the fight against treaty shopping?

1.4 Methodology

The research methodology adopted by this study is qualitative in nature. A qualitative research methodology entails conducting research that focuses on exploring and understanding complex phenomena, often involving human behaviour and experiences, in depth.[21] Qualitative research is characterised by its emphasis on the collection and analysis of non-numerical data, such as words, narratives, images, and observations.[22]

Relevant information has been collected from South African sources together with international sources in the form of legislation, case law, articles, textbooks, dissertations, and thesis. The information collected will revolve largely around the OECD's reports and recommendations pertaining to BEPS and treaty shopping. The research will give an overview of the extent to which South Africa complies with the OECD's recommendations and the changes that one could expect from South Africa going forward.

The US approach to treaty shopping will form the comparative aspect of this research. The US was chosen due to the vastly different approach they have taken in comparison

[21] Ugwu and Eze "Qualitative Research" 2023 *DOSR Journal of Computer and Applied Sciences* 1-2.
[22] As above.

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to that of South Africa. The US is a member of the OECD but has not signed or ratified the OECD's MLI. South Africa on the other hand, is not an OECD member but is a signatory to the MLI. South Africa and the US have a DTA in place. The approach of a developed state, such as the US, which has its own US Model Tax Treaty[23] will be in stark contrast to the approach used by South Africa.

1.5 Research Objectives

The objectives of this research are:

1.5.1 To evaluate treaty shopping practices and the extent it affects South African taxpayers as well as the State.

1.5.2 To evaluate the effectiveness of South Africa's domestic law in curbing treaty shopping.

1.5.3 To assess the extent to which South Africa complies with the regulations and recommendations outlined in the OECD's reports.

1.5.4 To compare South African regulations against those of the US to see which is more effective and whether there are lessons that can be learnt from the US.

1.5.5 To determine if treaty shopping is sufficiently regulated in South Africa and if not, the researcher will make recommendations.

1.6 Significance of the Study

This research holds importance due to several key factors. Firstly, it aims to provide clarity on South Africa's stance regarding treaty shopping, a practice that poses a significant threat to the state's tax base. By understanding South Africa's approach to combating

[23] United States Model Income Tax Convention 2016.

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treaty abuse, the research seeks to evaluate the effectiveness of the nation's efforts in countering harmful tax practices and protecting its national tax base.

Secondly, the research addresses the broader issue of BEPS, of which treaty abuse is a central concern. BEPS refers to strategies employed by MNEs to shift profits from high-tax jurisdictions to low-tax or no-tax jurisdictions, thereby eroding the tax base of states where economic activity actually occurs.[24] Treaty shopping, as a form of treaty abuse, exacerbates this problem by allowing income to escape taxation altogether or be taxed inadequately, contrary to the intentions of the parties involved in the tax treaty.[25]

Thirdly, the research emphasises the adverse consequences of treaty shopping, highlighting how it undermines the integrity of DTAs.[26] DTAs are intended to prevent double taxation and promote cooperation between jurisdictions. However, treaty shopping undermines this purpose by enabling residents of one jurisdiction to exploit treaty benefits intended for residents of another jurisdiction, without providing reciprocal benefits. This not only distorts the intended distribution of tax revenue but also reduces the incentive for jurisdictions to engage in meaningful tax treaty negotiations.[27]

Finally, this research compares the South African approach to that of the US, in order to gain a different perspective from the approach of a developed first world state and the efficacy thereof.

Overall, this research is significant as it delves into critical issues surrounding tax policy and international cooperation. By shedding light on South Africa's approach to treaty shopping and its implications for the national tax base, the research contributes to the global dialogue on combating BEPS and promoting fair and effective taxation practices.

1.7 Scope and Limitations of Study

This work discusses the operation of treaty shopping and the effectiveness of the OECD recommendations and domestic anti-avoidance legislation designed to curb the ensuing

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[24] OECD "BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances" (2014).
[25] As above.
[26] Avi-Yonah and Reuven "Rethinking Treaty Shopping: Lessons for the European Union" in *Tax Treaties: Building Bridges between Law and Economics* (2010) 6.
[27] As above.

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tax avoidance. The scope of this research pertains solely to BEPS in the form of treaty shopping. No other tax avoidance schemes are discussed.

The geographical scope of this research extends to South Africa and the US only. This research is limited to the guidelines and recommendations of the OECD, South African and US legislation pertaining and applicable to treaty shopping practices.

1.8 Overview of Chapters

1.8.1 Chapter 1: General Introduction

Chapter 1 of this thesis introduces the topic and includes the research problem, objectives and method of the study.

1.8.2 Chapter 2: Treaty Shopping and the Prevalence thereof in South Africa

Chapter 2 of this thesis looks into the development and parameters of the treaty shopping phenomenon, focusing on South Africa's position on and vulnerability to the practice.

1.8.3 Chapter 3: Regulation of Treaty Shopping by South Africa's Domestic Law

This chapter looks into South Africa's domestic rules and legislation that apply to treaty shopping. The concept of impermissible tax avoidance is introduced and the efficacy of the South African GAAR, SAAR and common law principles are considered. This chapter concludes with an overview of South Africa's current position regarding treaty shopping.

1.8.4 Chapter 4: Regulation of treaty shopping by International Tax Agreements

Chapter 4 looks at the OECD's reports and recommendations pertaining to BEPS and treaty shopping. The relationship between South Africa and the OECD is analysed and South Africa's level of compliance with OECD recommendations will be scrutinised.

1.8.5 Chapter 5: The US Regulation of Treaty Shopping

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This chapter will evaluate the US anti-treaty shopping provisions. The US has been at the forefront of the treaty shopping fight and has its own US Model Tax Treaty. A comparative study between South Africa and the US is conducted in order to ascertain what lessons South Africa can take from the US approach.

1.8.6 Chapter 6: Conclusion and Recommendations

This thesis concludes with chapter 6, where recommendations regarding how South Africa can improve their stance on treaty shopping are discussed and the thesis comes to a final conclusion.

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Chapter 2 Treaty Shopping and the Prevalence thereof in South Africa

2.1 Introduction

Obtaining and maintaining sustainable sources of tax revenue has proven to be an ongoing challenge for the South African government which is already financially constrained due to the high rates of unemployment and increases in the cost of living.[28] Protecting and maintaining a tax base is essential for South Africa to generate revenue, promote economic stability, reduce debt dependency, invest in development, and to foster good governance with their taxpayers.[29] It is therefore of great importance that South Africa curbs harmful tax practices such as treaty shopping.[30]

This chapter comprises of six parts. The first part of this chapter discusses how globalisation and the subsequent emergence of MNEs led to double taxation issues, fostering the need for tax treaties and subsequently creating the treaty shopping phenomenon. The second part of this chapter analyses South Africa's approach to tax treaties considering the ambiguity surrounding the hierarchy of treaty provisions versus domestic legislation. The third part of this chapter focuses solely on treaty shopping as a method of tax avoidance with the fourth part considering the benefits and disadvantages thereof. The fifth part of this chapter considers the effect treaty shopping has on South Africa itself, taking into account that South Africa is a developing state which relies heavily on tax revenue. Finally, this chapter summarises [KS2][th3]the findings of the abovementioned parts and provides clarity regarding the severity of treaty shopping damages to the South African economy.

2.2 Double Taxation and the Creation of the Global Tax Regime

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[28] Oguttu "International Tax Competition, Harmful Tax Practices and the 'Race to the Bottom': A Special Focus on Unstrategic Tax Incentives in Africa" 2018 *Comparative and International Law Journal of Southern Africa* 10.
[29] Oguttu 2018 *Comparative and International Law Journal of Southern Africa* 10.
[30] Ault and Arnold "Protecting the Tax Base of Developing Countries: An Overview" in *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2015) 1.

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The rise of MNEs brought forth the challenge of double taxation, where income is taxed in both the source and home/residence state.[31] To tackle this complexity and foster cross-border investment, states established DTAs.[32] These agreements allocate taxing rights, set tax rates, and provide relief mechanisms, easing compliance for MNEs and promoting international trade and investment.[33]

Double taxation occurs in two forms: economic, involving multiple taxation on the same income,[34] and judicial, involving tax paid twice on the same income source in different states.[35] The original goal of the global tax regime was to prevent judicial double taxation, facilitated by DTAs.[36] The global tax regime utilises measures like tax credits, exemptions, and the MAP[37] to address double taxation issues, supported by model tax treaties and the exchange of tax-related information.[38]

However, the global tax regime has spurred intense tax competition among states, with some offering low rates and incentives to attract MNEs.[39] While advantageous for MNEs, this practice raises concerns about fairness, eroding the global tax base and potentially hindering a state's ability to fund public services.[40] Addressing these challenges has become a focal point in international efforts to ensure equitable taxation and to prevent BEPS.[41]

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[31] Hattingh "Elimination of International Double Taxation" in De Koker and Brincker (eds) *Silke on International Tax* (2010) para 36.14.
[32] Fernandez and Pope "International Taxation of Multinational Enterprises (MNEs)" 2002 *Revenue Law Journal* 5.
[33] Fernandez and Pope 2002 *Revenue Law Journal* 5.
[34] Olivier and Honiball *International tax: a South African perspective* (2011) 6.
[35] As above.
[36] Arnold 2020 *United Nations, Department of Economic and Social Affairs* 13.
[37] Article 25 of the OECD Model Tax Convention provides for a Mutual Agreement Procedure. *"The MAP article in the DTA authorises the competent authority to assess the taxpayer's situation and resolve it through mutual agreement. This method involves a collaborative discussion between the competent authorities of the involved jurisdictions, avoiding the need for litigation. Although taxpayers do not formally participate in this process, they are encouraged to participate informally by providing all necessary information*" ; see SARS "Guide on Mutual Agreement Procedures" (2020) 3.
[38] UN "Analytical and historical review of international double taxation and tax evasion and avoidance" https://www.un.org/esa/ffd/wp-content/uploads/2014/10/2STM_Taxation-EC18-2006-7-part1-R.pdf (accessed 9 October 2023).
[39] Rixen 2011 *Review of International Political Economy* 4.
[40] As above.
[41] Oguttu 2018 *Comparative and International Law Journal of Southern Africa* 10.

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2.3 Tax Treaties in the South African context

In South Africa, the framework governing the status of international agreements, including DTAs, is outlined in Section 231 of the Constitution.[42] According to this constitutional provision, the responsibility for negotiating and signing all international agreements lies with the national executive.[43] This branch of the national government holds the responsibility for administering daily governmental functions. It comprises the President, the Deputy President, and the remaining members of the Cabinet.[44] For an international agreement to be binding on the Republic, it must receive approval through a resolution in both the National Assembly and the National Council of Provinces, unless falling within specific categories outlined in subsection 3.[45] Such agreements, when entered into by the national executive, bind the Republic without the need for approval by the National Assembly and the National Council of Provinces. However, they must be presented to both houses within a reasonable time for information.[46]

Additionally, Section 231(4) clarifies that any international agreement attains the status of law in South Africa when enacted through national legislation. Notably, a self-executing provision of an agreement, approved by Parliament, holds legal force unless it contradicts the Constitution or an Act of Parliament.[47]

Also pertaining to tax treaties, Section 108 of the Income Tax Act outlines that the National Executive is empowered to engage in agreements with other states' governments.[48] These agreements are designed to establish arrangements that aim to prevent, mitigate, or discontinue the imposition of taxes on the same income, profits, or gains under the laws of both South Africa and the partnering state.[49] Additionally, the agreements facilitate

[42] The Constitution of the Republic of South Africa 1996.
[43] Chapter 5 of the Constitution of the Republic of South Africa pertains to the president and the National Executive.
[44] Roberts "The President and the National Executive" in *Constitutional Law for Students* (2020) 110.
[45] Section 231 (3) of the Constitution states that "*An international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by the National Assembly and the National Council of Provinces, but must be tabled in the Assembly and the Council within a reasonable time.*"
[46] As above.
[47] Section 231 (4) of the Constitution.
[48] Act 58 of 1962.
[49] Section 108 (1) of the Income Tax Act.

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reciprocal assistance in administering and collecting taxes under the laws of both South Africa and the other state.[50] Following the approval by Parliament, as outlined in Section 231 of the Constitution, the details of these arrangements are published in the Gazette, and they subsequently come into effect as if they were enacted in the Income Tax Act.[51]

The legislation outlined above reveals that South Africa adheres to a dualist approach concerning the domestic impact of international treaties.[52] Although the ratification of a treaty establishes international obligations for South Africa, the dualist system necessitates the incorporation of the treaty into domestic legislation for these obligations to carry legal weight domestically.[53] DTAs, being dual in nature as both components of domestic legislation and classified as international agreements, hold equivalent legal significance to other sections within the Income Tax Act.[54] Consequently, they are subject to interpretation in accordance with the rules governing the interpretation of statutes in South Africa.

Regrettably, South African courts have demonstrated inconsistency in their interpretation of the law when domestic law and DTA provisions clash. They have yet to establish a consistent stance on whether a DTA, once integrated into South African domestic law, holds a superior, inferior, or equal status compared to the Income Tax Act.[55]

In the *AM Moolla* case, the court was of the view that the provisions of the DTA ranked lower than that of domestic legislation. The court asserted that the treaty is an integral part of the Customs and Excise Duty Act,[56] and that in situations of conflict between the general provisions of the Act and specific treaty provisions, the Act takes precedence.[57]

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[50] Section 108 (1) of the Income Tax Act.
[51] Section 108 (2) of the Income Tax Act.
[52] Section 231(2) of the Constitution.
[53] Section 231 (4) of the Constitution.
[54] Section 108 (2) of the Income Tax Act.
[55] See *Commissioner for the South African Revenue Service v Van Kets*, *Commissioner for South African Revenue* 2003(6) SA 244 (SCA).
Services v Tradehold Ltd 2012 74 SATC 263, *AM Moola Group Ltd v Commissioner for the South African Revenue* 2003 (6)
Service 65 SATC 414 and *Glenister v President of the RSA* 2011 3 SA 347 (CC).
[56] Act 91 of 1964.
[57] *AM Moola Group Ltd v Commissioner for the South African Revenue Service* para 20.

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However, the court emphasised the need to interpret the treaty to avoid further conflicts with the Act.[58]

In *Glenister v President of the RSA*, both the minority and majority judgments conveyed that ordinary domestic statutory obligations arise upon the domestication of a treaty through legislation, placing the provisions of domestic law and those of the treaty on par with one another.[59] The minority opinion held that conflicts between a domesticated international agreement and other domestic legislation should be resolved through principles of statutory interpretation and superseding legislation.[60] The court in *Glenister* emphasised that "*the incorporation of an international agreement creates ordinary domestic statutory obligations. Incorporation by itself does not transform the rights and obligations in it into constitutional rights and obligations*."[61]

The *Van Kets*[62] judgment aligned with the minority view in *Glenister*,[63] stating that DTA provisions become part of domestic tax legislation.[64] Judge Davis J emphasised that, according to Section 231 of the Constitution, DTA provisions must hold at least equal standing with domestic law.[65] Consequently, the DTA and the Act should be harmonised and interpreted as a coherent whole.[66]

Contrastingly, the Supreme Court of Appeal in *Tradehold* asserted that a DTA modifies domestic law and will apply in preference to the domestic law in case of conflict, thus ranking the status of treaty provisions as being higher than that of domestic legislation.[67] The court highlighted the importance of interpreting DTAs to obtain its intended purpose.[68]

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[58] *AM Moola Group Ltd v Commissioner for the South African Revenue Service* para 27.
[59] *Glenister v President of the RSA* para 10.
[60] See the minority judgement of Ncgobo CJ in *Glenister v President of the RSA* para 92.
[61] *Glenister v President of the RSA* 2011 3 SA 347 (CC) para 181
[62] *Commissioner for the South African Revenue Service v Van Kets*
[63] *Glenister v President of the RSA*.
[64] *Commissioner for the South African Revenue Service v Van Kets* para 25.
[65] As above.
[66] *Commissioner for the South African Revenue Service v Van Kets* para 16.
[67] *Commissioner for South African Revenue Services v Tradehold Ltd* para 12.
[68] *Commissioner for South African Revenue Services v Tradehold Ltd* para 21.

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The author of this work agrees with the approach taken by the courts in *Glenister* and *Van Kets*, by placing the provisions of a DTA on equal standing to that of domestic tax legislation and attempting to interpret the two in the most harmonious way possible.

While courts have shown inconsistency, academics also hold differing perspectives. Costa and Stack advocate for the "treaty override" rule, rooted in the understanding that tax treaties serve to allocate taxation rights and prevent double taxation through bilateral negotiations between nations.[69] They argue that DTA provisions should take precedence over conflicting elements of the Income Tax Act. However, the author of this study opposes Costa and Stack's stance on the basis that the status of DTAs in South Africa is determined by the Constitution and therefore only the Constitution can authorise a treaty override.[70] Hattingh further contends that a treaty override would breach South Africa's international law obligations. Additionally, South Africa has yet to enact legislation intended to facilitate a treaty override.[71] Despite this, given that the South African Constitution does not explicitly prohibit a treaty override, the legislature should carefully deliberate whether to exercise this authority. Du Plessis similarly rejects a treaty override, advocating for resolving conflicts through principles of statutory interpretation initially.[72]

Though South Africa is not party to the Vienna Convention,[73] the principles guiding treaty interpretation are considered customary international law under Section 232 of the Constitution, which states that "*customary international law is law in the Republic unless inconsistent with the Constitution or an Act of Parliament*." [74] The general rules of interpretation contained in Article 31 of the Vienna Convention[75] align with the principles of statutory application in South Africa, emphasising interpretation based on a treaty's objects and purposes, akin to legislative intent in domestic law.[76] Courts must consider the Vienna Convention when interpreting DTAs, prioritising objectives such as the

[69] Costa and Stack "The relationship between Double Taxation Agreements and the provisions of the South African Income Tax Act" 2014 Journal of Economic and Financial Sciences 9.
[70] Section 231 of the Constitution.
[71] Hattingh "Elimination of International Double Taxation" para 36.14.
[72] Du Plessis "The incorporation of Double Taxation agreements into South African domestic law" 2015 *Potchefstroom Electronic Law Journal* 15.
[73] Vienna Convention on the Law of Treaties 1969.
[74] Section 232 of the Constitution of the Republic of South Africa 1996.
[75] Article 31 of the Vienna Convention on the Law of Treaties 1969.
[76] Section 232 of the Constitution of the Republic of South Africa 1996.

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elimination of double taxation. This stance is supported in both the *van Kets* and *Tradehold* cases.[77]

This study aligns with du Plessis' preference for resolving conflicts through statutory interpretation rather than a treaty override. While a treaty override is possible under the Constitution, the focus should first be on principles of statutory interpretation for relief in cases of conflict.

2.4 Factors that encourage treaty shopping

Treaty shopping is driven by several key factors. It allows taxpayers to optimise their tax liabilities by accessing preferential tax rates, deductions, and exemptions offered in treaty partner states, reducing tax obligations.[78] For example, suppose an MNE is headquartered in state A, which has a tax treaty with state B that reduces withholding taxes on dividends or interest payments. However, the corporation's subsidiary in state A has significant operations in state C, which does not have such favourable tax treaties with state B. In this scenario, the corporation may structure its transactions in a way that routes payments through its subsidiary in state B to take advantage of the beneficial tax provisions in the treaty between state A and state B, effectively reducing its overall tax burden.

Treaty shopping not only enables MNEs to minimise tax burdens but also provides additional benefits such as asset protection and confidentiality, which may not be available in their home states.[79] This facilitates international business transactions and investments, allowing for diversified tax exposures and reduced compliance burdens.[80]

Moreover, certain states actively encourage treaty shopping as a means to attract foreign investments and stimulate economic growth, rendering it an appealing option for global

[77] *Commissioner for the South African Revenue Service v Van Kets* para 98; *Commissioner for South African Revenue Services v Tradehold Ltd* para 15.
[78] Avi-Yonah and Reuven (2010) 7.
[79] Avi-Yonah and Reuven (2010) 8.
[80] As above.

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investors.[81] The non-neutrality of international tax systems arises from states participating in tax competition to lure economic activities away from other jurisdictions.[82]

2.5 Disadvantages of treaty shopping

Treaty shopping, while offering advantages, comes with its share of disadvantages. These include the potential for abuse and tax avoidance, which can undermine the integrity and fairness of tax systems in both the taxpayer's home state and in the treaty partner state.[83] Treaty shopping can lead to a reduction in a state's tax base as income is shifted to more favourable jurisdictions, potentially depriving states, such as South Africa of much-needed revenue. Treaty shopping is seen as a manner in which taxpayers are able to undermine the spirit and the purpose of a DTA, which is meant to have reciprocal benefits for both parties involved, and not to be used as a tax evasion tool for third parties.[84] If a resident of a third state engages in treaty shopping, they can access treaty benefits even when their home state has not been part of the agreement and may not offer similar advantages in return, such as sharing tax information.[85] This disrupts the standard reciprocity principle of the treaty, undermining its intended purpose and subverting the process; treaty shopping creates a disincentive for states to negotiate DTA's.[86] If third states can get the benefits of reduced taxation for their residents without conferring reciprocal benefits to non-resident investors, then there is no need to enter into a DTA.[87]

Determining the eligibility for treaty benefits can be complex and can involve a significant administrative burden for tax authorities in enforcing anti-abuse measures. Treaty shopping can lead to costly legal disputes, increased anti-avoidance measures, and

[81] OECD Report "Foreign Direct Investment for Development – Maximising Benefits, Minimising Costs" (2002) 5 https://www.oecd.org/investment/investmentfordevelopment/1959815.pdf (accessed 8 May 2023).
[82] Avi-Yonah and Reuven (2010) 11.
[83] Avi-Yonah and Reuven (2010) 6.
[84] As above.
[85] Avi-Yonah and Reuven (2010) 11.
[86] See OECD Report on Conduit Companies (Para. 7(a)) and the UN Report on the Prevention of Abuse of Tax Treaties Conduit Companies Report, Para. 7(a).
[87] Avi-Yonah and Reuven (2010) 7.

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treaty modifications to address loopholes.[88] Furthermore, it can result in inequities as certain taxpayers and industries may benefit disproportionately from these practices, while others do not.[89]

2.6 Treaty shopping in South Africa

Treaty shopping is prevalent in South Africa. The corporate tax rate in South Africa has been 28% since 2008 but was reduced to 27% for years of assessments commencing on or after 1 April 2022.[90] South Africa's corporate income tax rate exceeds the OECD's average of 23%.The incentive for MNE's to shift profits out of South Africa, where the corporate tax rate is significantly higher than many other jurisdictions, is certainly present.[91]

Research done by SA-TIED,[92] indicates that half of all profits shifted out of South Africa are moved to Switzerland where the corporate income tax rate is 8.5%.[93] Switzerland is a well-known and widely preferred tax haven[94] for MNE's, as the Swiss government offers significant tax breaks to companies that hold 10% shares of other corporations by reducing the amount of taxes a corporation owes on profit based on the number of shares it owns.[95] Switzerland has a network of DTAs with numerous states, allowing for the reduction of withholding taxes and favourable tax treatment in cross-border transactions.

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[88] UN Report "International Co-operation in Tax Matters, Contributions to international co-operation in tax matters: treaty shopping, thin capitalisation, co-operation between tax authorities, resolving international tax disputes" (1988) 6.
[89] Avi-Yonah and Reuven (2010) 7.
[90] National Treasury Budget Review (2020) 50.
[91] Business Tech "Treasury proposes a percentage reduction in corporate income tax" (2022) https://businesstech.co.za/news/budget-speech/561916/treasury-proposes-a-percentage-reduction-in-corporate-income-tax/#:~:text=Effective%20for%20tax%20years%20ending,its%202022%20Budget%20on%20Wednesday (accessed 7 November 2022).
[92] The Southern Africa – Towards Inclusive Economic Development (SA-TIED) is a program intended to support policymaking in the Southern Africa region by working closely with researchers to close knowledge gaps crucial to the achievement of inclusive growth and economic transformation.
[93] Davis Tax Committee "Second interim report on BEPS in South Africa" 2016 26.
[94] The OECD defines a tax haven as "*a jurisdiction that actively makes itself available for the avoidance of tax that would have been paid in high-tax countries*." See OECD "Issues in international 5 taxation No 1: international tax avoidance and evasion (Four related studies)" (1987) 1.
[95] Swiss Tax Conference Information Committee (2021) "*The Swiss Tax System*" 24.

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Resultantly, shell corporations often set up operations in Switzerland to take advantage of low or no taxation.[96]

In 2018, an estimated 19% of all tax receipts in South Africa were generated by the collection of corporate income tax.[97] It is imperative that South Africa acts swiftly to curb profit-shifting practices, in order to collect as much corporate tax as possible. Tax base erosion, profit-shifting and international tax competition undoubtedly do far more harm than good to the economic situation of South Africa.[98]

2.7 Conclusion

This chapter on treaty shopping highlights the significant impact of this practice on both the global tax landscape and, more specifically, on South Africa's economy.

South Africa's high corporate income tax rates encourage treaty shopping. Treaty shopping poses a serious challenge to sustainable tax revenue sources and has led to substantial revenue losses for South Africa, which already faces financial constraints due to high unemployment rates and rising living costs. Factors such as preferential tax rates and incentives encourage taxpayers desire to engage in treaty shopping. Protecting and maintaining the tax base is crucial for South Africa. A healthy tax base enables the government to meet citizens' needs, promote economic growth, and create a sustainable future for the state.

The following chapter discusses the regulation of treaty shopping in South Africa.

[96] Davis Tax Committee "Second interim report on BEPS in South Africa" 2016 28.
[97] Wier and Reynolds 2018 *WIDER Working Paper* 9.
[98] As above.

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Chapter 3: Regulation of Treaty Shopping by South Africa's Domestic Law

3.1 Introduction

The South African Revenue Service ("SARS") maintains a staunch commitment to tax compliance and takes a dim view of any attempts at tax avoidance; consequently, numerous avoidance schemes are classified as "impermissible."[99]

Impermissible tax avoidance has been described by SARS as:

> "*artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived 'loopholes' in the tax laws in order to achieve results that conflict with or defeat the intention of Parliament.*"[100]

This chapter critically discusses the domestic law rules (GAAR, SAARs and common law principles) available in South Africa to curb treaty-shopping practises.

3.2 General Anti-Avoidance Rules ("GAAR")

A GAAR is a legislative provision aimed at countering tax avoidance schemes that exploit loopholes in tax laws to achieve tax benefits contrary to the intended purpose of those laws.[101] GAARs are broadly drafted to capture various tax avoidance strategies, such as treaty shopping, focusing on the substance rather than the form of transactions and assessing whether their main purpose or one of their main purposes is to obtain a tax advantage.[102] The South African GAAR is outlined in Part IIA of the Income Tax Act consisting of 12 sections (80A to 80L) and in section 103 of the Act.

[99] SARS Discussion Paper on Tax Avoidance 2005 1.
[100] SARS Discussion Paper on Tax Avoidance 2005 4.
[101] Waerzeggers and Hillier "Introducing a General Anti-Avoidance Rule" 2016 *Tax Law IMF Technical Note* 5.
[102] As above.

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3.2.1 Section 103 of the Income Tax Act

Section 103 of the Income Tax Act provides a GAAR addressing transactions, operations, or schemes aimed at evading or reducing tax liabilities.

Section 103(2) empowers the Commissioner to disallow the offsetting of an assessed loss against a taxpayer's income if certain conditions are met.[103] These conditions include situations where an agreement affecting a company or a change in the company's shareholding has resulted in the company receiving income during the assessment year. If it is determined that such agreements or changes were primarily or solely undertaken to utilise assessed losses to avoid or reduce tax liability, the Commissioner has the authority to disallow the assessed losses.[104]

Furthermore, Section 103(4) places the burden of proof on the taxpayer. If it is shown that an agreement or change in shareholding has resulted in the avoidance or deferral of tax liability or the reduction of its amount, there is a presumption that the agreement or change was made primarily or solely to utilise assessed losses to avoid or reduce tax liability.[105] It is then the taxpayer's responsibility to refute this presumption by demonstrating that the agreement or change was made for commercial purposes and not primarily or solely for tax avoidance.[106]

These provisions of the Income Tax Act create a deterrent against treaty shopping by requiring taxpayers to justify their transactions or changes in shareholding with legitimate commercial objectives rather than tax avoidance motives.[107] By placing the burden of proof on the taxpayer and empowering the Commissioner to disallow assessed losses in cases of tax avoidance, the legislation helps safeguard against abusive practices aimed at exploiting tax treaties for undue tax benefits.

3.2.2 Section 80A-L of the Income Tax Act

[103] Section 103(2) of the Income Tax Act.
[104] As above.
[105] Section 103(4) of the Income Tax Act.
[106] As above.
[107] Section 103(2) of the Income Tax Act.

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Section 80A serves as the defining provision for "impermissible tax avoidance arrangement," An arrangement is deemed impermissible if its primary purpose is obtaining a tax benefit. The criteria for impermissibility include business contexts where the arrangement should align with *bona fide* business purposes and not lack commercial substance.[108] In non-business contexts, the arrangement should not be employed in a manner inconsistent with a *bona fide* purpose, unless for obtaining a tax benefit. Additionally, the provision considers whether the arrangement creates rights or obligations not typically formed at arm's length or if it directly or indirectly results in the misuse or abuse of the provisions of the Income Tax Act.[109]

From the above, one can see that there are multiple elements to consider before an avoidance arrangement can considered “impermissible”. These requirements are mainly:

- The presence an arrangement;
- results in a “tax benefit;
- The sole or main purpose of the transaction, operation or scheme must be to obtain a tax benefit;
- The tainted element. arrangement must be abnormal, lacking in commercial substance, carried out in a manner not normally employed for bona fide business purposes, create rights and obligations not normally arising between parties dealing at arm’s length or be abusive of the provisions of the Income Tax Act.[110]

Arrangement

For GAAR provisions to be applicable, the initial requirement is the existence of an arrangement, as defined in section 80L of the Act. An arrangement, encompassing any transaction, operation, scheme, agreement, or understanding, involves two or more consciously involved parties who have discussed and agreed upon the manner in which they will conduct future dealings, including the alienation of property.[111] The term 'arrangement' implies a deliberate collaboration. Section 80L grants the commissioner the

[108] Section 80A (a)(i-ii) of the Income Tax Act.
[109] Section 80A (b)(c)(i-ii) of the Income Tax Act.
[110] Act 58 of 1962.
[111] S80L of the Income Tax Act.

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authority to apply GAAR to individual steps within larger arrangements. This empowerment, outlined in section 80H, aims to prevent taxpayers from inserting steps with the ulterior motive of obtaining a tax benefit into a larger arrangement lacking a genuine tax purpose.[112] Treaty shopping could qualify as an arrangement in terms of section 80L of the Income Tax Act.[113]

Tax Benefit

Section 80L of the Income Tax Act addresses the concept of a "tax benefit" and defines it broadly as encompassing "*any avoidance, postponement, or reduction of any liability for tax*." The magnitude of the tax benefit derived from an arrangement is inconsequential; the requirement is satisfied regardless of its size.[114] The entire premise of a treaty shopping scheme revolves around attaining a tax benefit, such as the avoidance of withholding taxes. Numerous tax treaties stipulate reductions or eliminations of withholding taxes on specific income types paid to residents of the treaty partner state.[115] By structuring transactions through a resident or entity in that partner state, one can sidestep withholding taxes that would otherwise apply, thereby preserving a more substantial portion of the income and yielding a significant tax benefit.[116]

Sole or main purpose

Upon determination that the avoidance arrangement has resulted in a tax benefit, the arrangement can only be successfully tackled by the GAAR if its "sole or main purpose" was to obtain the tax benefit, as stated in section 80A of the Act.[117] The "main purpose test" exists in section 80(G) (1) of the Act and creates a rebuttable presumption that the sole or main purpose of the arrangement was to obtain a tax benefit.[118] The onus of this test rests on the taxpayer, who must provide conclusive evidence to discharge the presumption. This evidence must satisfy the court upon a balance of probability that

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[112] De Koker and Williams "Tax Avoidance" in *Silke on South African Income Tax* (2022) 19.36.
[113] Davis Tax Committee Interim report "Addressing base erosion and profit shifting in South Africa" 71 http://bit.ly/2dhBXdH (accessed 6 June 2022).
[114] De Koker and Williams (2022) para 19.38.
[115] Leduc and Michielse (2021) 151.
[116] Leduc and Michielse (2021) 153.
[117] De Koker and Williams (2022) para 19.38.
[118] As above.

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"*reasonably considered in light of the relevant facts and circumstances, obtaining the tax benefit was not the sole or main purpose of the arrangement.*[119]

Tainted Elements

An avoidance arrangement must have one or more of the four tainted elements (abnormality,[120] lack of commercial substance,[121] creation of rights or obligations not at an arm's length,[122] and misuse or abuse of the provisions of the Act[123]) to trigger the GAAR.

Abnormality questions if the arrangement deviates from typical business practices solely for tax benefits,[124] often seen in complex treaty shopping structures.[125] Kujinga argues that because "normal" is not statutorily defined it will be left to the courts to determine what constitutes "normal".[126] This is likely to lead to inconsistent judicial decisions and standards that will limit the efficacy of the GAAR.[127] MNE's frequently restructure corporations and investments in a manner that would seem abnormal and even random to someone who lacks knowledge in tax and treaty developments.[128]

Section 80A(a)(ii) introduces the lack of commercial substance test, only applicable in business arrangements and considered with section 80C.[129] An arrangement lacks commercial substance if it offers a significant tax benefit without significantly affecting business risk or net cash flows. Kujinga questions how the courts will determine the meaning of the term "significant" in this context and raises the question "*Does it mean that an arrangement cannot be said to lack commercial substance if its tax benefit is not significant?*" This lack of legal certainty is undoubtedly problematic.[130] Treaty shopping

[119] S80G of the Income Tax Act.
[120] S80A (a)(i) of the Income Tax Act.
[121] S80A (a)(ii) of the Income Tax Act.
[122] S80A (c)(i) of the Income Tax Act.
[123] S80A (c)(ii) of the Income Tax Act.
[124] De Koker and Williams (2022) 19.39.
[125] Avi-Yonah and Reuven (2010) 5.
[126] Kujinga A comparative analysis of the efficacy of the GAAR as a measure against impermissible income tax avoidance in South Africa (LLD thesis 2013 University of Pretoria) 112.
[127] Kujinga 112.
[128] Aykut, Sanghi and Kosmidou "What to Do When Foreign Direct Investment Is Not Direct or Foreign - FDI Round Tripping" 2017 *World Bank Group Policy Research Working Paper 8046* 6.
[129] S80C of the Income Tax Act.
[130] Kujinga 112.

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often involves conduit or "letterbox" companies with no economic substance, serving merely to show physical presence for nationality maintenance.[131] These entities, though not income-generating, act as vehicles for profit shifting or fictitious financial flows by their holding companies.[132]

The final tainted element involves the misuse or abuse of Act provisions.[133] This doctrine implies that even if the Income Tax Act's provisions are followed, an arrangement can still be deemed abusive.[134] Treaty shopping aligns with this element as it relies on the misuse and abuse of treaty provisions to obtain tax benefits.[135] Considering the rules and requirements, treaty shopping is undoubtedly an impermissible avoidance arrangement in the South African legal context. The likelihood of one or more tainted elements existing in conduit company treaty shopping schemes is high, making them susceptible to the GAAR's punitive measures.[136]

Remedies

The Commissioner has various remedies at his disposal for impermissible tax avoidance arrangements. These remedies can be applied to any part or the entirety of the arrangement.[137] A general remedy in section 80B(1)(f) allows the Commissioner to treat the impermissible avoidance arrangement as if it had not occurred, determining an appropriate tax liability for the transaction if it had been carried out legitimately.[138]

More specific remedies are detailed in sections 80B(1)(a) to (e), enabling the Commissioner to disregard or combine arrangement steps, consider different parties as the same entity, and reallocate or reclassify income, expenses, or rebates. Section 80B(2) mandates that the Commissioner makes necessary adjustments to ensure consistent treatment of all parties involved, subject to objections, appeals, and standard three-year

[131] Aykut, Sanghi and Kosmidou 2017 *World Bank Group Policy Research Working Paper* 8046 6.
[132] Aykut, Sanghi and Kosmidou 2017 *World Bank Group Policy Research Working Paper* 8046 8
[133] Section 80A (c)(ii) of the Income Tax Act.
[134] De Koker and Williams (2022) 19.39.
[135] As above.
[136] Pidduck *The South African GAAR and lessons from the first world: A case law approach* (PHD Thesis 2017 Rhodes University) 303.
[137] Section 80B of the Income Tax Act.
[138] Section 80B (1)(f) of the Income Tax Act.

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prescription rules.[139] To defend against allegations of participating in a treaty shopping scheme, a taxpayer must demonstrate that the arrangement was conventional, had actual commercial substance, and that tax benefits were unintended, not a result of misusing or abusing DTA provisions or any other legislation.[140]

Efficacy of the GAAR

Historically, research on the efficacy of the South African GAAR has been centred on theoretical analyses, given the limited judicial interpretations available.[141] These studies delve into the substance of the GAAR to identify weaknesses and areas for improvement.[142] Pidduck's article on the *Sasol* case[143] serves as a noteworthy example. Pidduck sought to assess whether the existing GAAR could withstand judicial scrutiny when confronted with circumstances similar to those in *Sasol*, which was subject to the prior GAAR version.[144]

The *Sasol* case[145] involved contracts between Sasol Oil (Pty) Ltd (Sasol Oil), Sasol International Services Ltd (SISL), and Sasol Oil International Ltd (SOIL). These contracts, which SARS considered simulated, led to additional assessments for the 2005 to 2007 tax years. The dispute traces back to 1991 when the Sasol group started procuring oil directly from foreign suppliers in the Middle East and Western Africa, establishing subsidiaries such as Sasol Trading International Ltd (STI) in the Isle of Man and Sasol Trading Services Limited in the UK (later renamed SISL). STI, for years, negotiated term contracts for crude oil, delivered to Sasol Oil in Durban, South Africa. In 2001, the procurement structure changed, with STI purchasing oil from suppliers and selling it to SISL on a free on-board port-of-loading basis. SISL then resold the oil and arranged its shipment to Sasol Oil in Durban using a delivered ex ship basis.

[139] Section 80B(2) of the Income Tax Act.
[140] De Koker and Williams (2022) para 19.39.
[141] Pidduck 303.
[142] De Koker and Williams (2022) para 19.39.
[143] *Sasol Oil v CSARS* (2018) ZASCA 153 (A).
[144] Pidduck (2020) "The Sasol Oil case - would the present South African GAAR stand up to the rigours of the court?" *South African Journal of Accounting Research* 5.
[145] *Sasol Oil v CSARS* (2018) ZASCA 153 (A).

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The dispute arose in 2010 when SARS challenged the authenticity of the oil sales contracts for the years 2005, 2006, and 2007. SARS argued that the arrangement, where SOIL sold oil to SISL, which then sold it to Sasol Oil, was a mere simulation. According to SARS, the true intention was for SOIL to directly sell oil to Sasol Oil, and SISL had no genuine commercial role or risk in the transaction. On this basis, SARS attributed the profits earned by SOIL to Sasol Oil, invoking section 9D of the Act, and issued additional assessments. Despite objections raised by Sasol Oil, the Tax Court ruled in favor of the Commissioner, concluding that the contracts were a sham, and the true agreement was for SOIL to directly sell the oil to Sasol Oil.[146]

When applying the current GAAR to the *Sasol* case, Pidduck noted that the transactions may constitute an avoidance arrangement, as they may result in a tax benefit.[147] This is due to SISL's involvement, which prevented the apportionment of net income from SOIL to Sasol Oil under section 9D of the Act.[148] It is unlikely that the sole or main purpose requirement would be met, as both subjective and objective tests support the notion that the primary purpose of the arrangement was to manage oil procurement and shipping between two entities (one in London and one in the Isle of Man), ultimately delivering oil to Sasol Oil in Durban. However, when analysing the tainted elements requirement, arguments suggest that the arrangement may have lacked commercial substance.[149]

Ultimately, Pidduck found it unlikely that the *Sasol* case arrangements would constitute an impermissible avoidance arrangement, as they fail to meet all the requirements of the current GAAR.[150]

Since the enactment of the existing GAAR, only a limited number of cases have been brought before our courts to assess the application of these provisions. Three cases pertaining to the current GAAR will be discussed in this chapter; these are the combined cases of *Mr X v The Commissioner for the South African Revenue Service*[151] and *Mr Y v*

[146] *Sasol Oil v CSARS* para 36.
[147] Pidduck (2020) *South African Journal of Accounting Research* 12.
[148] 58 of 1962.
[149] Pidduck (2020) *South African Journal of Accounting Research* 20.
[150] Pidduck (2020) *South African Journal of Accounting Research* 29.
[151] *Mr X v The Commissioner for the South African Revenue Service* (Case No IT24502).

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The Commissioner for the South African Revenue Service[152] and *Commissioner for the South African Revenue Service v Absa Bank Limited and Another*.[153]

The combined cases of Mr. X and Mr. Y were examined on the 12th of November 2020, the Tax Court in this case examined the application of the GAAR focusing on the interpretation thereof.

Both taxpayers underwent SARS audits for specific assessment years, leading to the issuance of section 80J notices signifying intent to apply the GAAR. The notices alleged that the taxpayers had engaged in impermissible tax avoidance arrangements. Both Mr X and Mr Y challenged these notices and contended that SARS had erred in applying the GAAR. Challenges arose regarding the reviewability of decisions not to withdraw section 80J notices, with the Tax Court initially categorizing the challenges as primarily legal under the section 105 of the TAA. The SCA disagreed, emphasizing the mix of factual and legal aspects involved in GAAR-related disputes.

The court noted the significant departure between the old[154] and new GAAR[155] regarding SARS's requirement to be "satisfied" under the old provisions and its shift to an opinion-based trigger in the new GAAR.[156] Therefore, the court held that previous cases regarding the interpretation of the old GAAR were not relevant in interpreting the new GAAR provisions.[157]

Regarding the duty to begin and the onus of proof, the court emphasised that SARS carries the initial burden of proving the existence of an "impermissible avoidance arrangement" and therefore in the case of a dispute regarding such an arrangement, SARS would need to commence leading evidence.[158]

This judgement had significant implications for GAAR-related decision review and the nature of such disputes. The SCA clarified that GAAR challenges often involve a blend of

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[152] *Mr Y v The Commissioner for the South African Revenue Service* (Case No IT24503) (as yet unreported).
[153] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* (596/2021) [2023] ZASCA 125.
[154] Section 103(1) of the Income Tax Act 58 of 1962.
[155] Sections 80A to 80L of the Income Tax Act 58 of 1962.
[156] *Mr X v The Commissioner for the South African Revenue Service* para 69.
[157] *Mr X v The Commissioner for the South African Revenue Service* para 104.
[158] *Mr X v The Commissioner for the South African Revenue Service* para 115.

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factual and legal considerations, affecting judicial review and leading to a nuanced approach in determining their admissibility.[159]

The *SARS v Absa* case[160] is significant for its insights into how the GAAR functions in South African tax law and the court's role in determining its application.[161]

In 2016 SARS began an investigation into a series of transactions involving Absa Bank and various entities, resulting in a tax audit covering the 2015, 2016, and 2017 tax periods. Thereafter, SARS issued notices under section 80J of the Income Tax Act,[162] expressing its intention to apply the GAAR and alleging that Absa Bank engaged in an impermissible tax avoidance arrangement. Absa Bank requested the withdrawal of these notices, citing a legal error in the application of the GAAR. SARS declined to withdraw the notices and Absa Bank initiated a review application to challenge the refusal to withdraw the section 80J notices and concurrently submitted responses to these notices. While this application was pending, SARS, using section 80B of the Income Tax Act, determined that Absa Bank owed additional tax, issuing assessments in October 2019. These assessments were based on the assertion that Absa Bank was involved in an impermissible avoidance arrangement. Consequently, Absa Bank expanded its review application to encompass these assessments. The high court deemed the decision not to withdraw the section 80J notices as subject to review, considering the close connection between the notices and assessments and categorizing them as exceptional circumstances for its jurisdiction under section 105 of the Tax Administration Act.[163]

The SCA addressed several crucial issues in response. It found that the refusal to withdraw the section 80J notices had no practical impact and was not subject to review since tax liability had already been imposed under section 80B.[164] Regarding the review of the assessments, the SCA clarified that the high court's jurisdiction should only be invoked under exceptional circumstances and corrected the characterisation of the

[159] De Koker and Williams *Silke on South African Income Tax* (2023) para 19:35.
[160] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 4.
[161] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* paras 2-5.
[162] 58 of 1962.
[163] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 11.
[164] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 13.

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dispute as primarily legal, asserting that both factual and legal issues were involved.[165] Consequently, the SCA upheld the appeal and replaced the high court's orders with a dismissal of the application and awarded costs.[166]

The SCA's decision reinforces the prudent application of the GAAR, cautioning against its indiscriminate use to challenge legitimate commercial transactions. It reiterates that the GAAR should not be invoked unless essential elements for its application are present, including the existence of an impermissible avoidance arrangement, a tax benefit, characteristics of abnormality or a lack of commercial substance, and a primary purpose of obtaining a tax benefit.[167]

GAARs are intended to clarify the boundary between acceptable and unacceptable tax avoidance, offering taxpayers clear guidance on their tax planning limits.[168] Nevertheless, South African case law and GAAR revisions lack sufficient interpretative direction, resulting in ongoing application challenges.[169] Notably, the GAAR lacks robust penalties for those employing impermissible avoidance arrangements, typically requiring them to pay the taxes they sought to avoid, without additional consequences.[170]

Regardless, the South African GAAR reflects the states proactive and resolute stance against tax avoidance schemes, demonstrating its commitment to combat BEPS and safeguard the nation's vulnerable tax base.

3.3 Specific Anti-Avoidance Legislation

SAARs are anti-avoidance rules that regulate or prohibit tax avoidance in specific circumstances or transactions.[171] SAARs are incorporated into legislation with the intention of closing loopholes that are exploited by taxpayers by using specifically defined transactions. Ironically, the efficacy of SAARs is often diminished by the fact that the specificity thereof can create more loopholes for innovative taxpayers looking to avoid

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[165] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 33.
[166] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 35.
[167] *Commissioner for the South African Revenue Service v Absa Bank Limited and Another* para 12.
[168] Kujinga 2014 *The Comparative and International Law Journal of Southern Africa* 3.
[169] Pidduck 304
[170] Pidduck 303.
[171] Haupt *Notes on South African Income Tax* (2012) 499.

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taxes by changing the form of a particular transaction.[172] It is for this reason that the incorporation of a GAAR is necessary as the GAAR adds to the specific requirements created by SAARs and creates a general requirement not confined to specifically defined transactions.[173]

The SAAR's that are relevant to this chapter are discussed below.

3.3.1 Section 9D of the Income Tax Act

Section 9D of the Act plays an indirect role in preventing treaty shopping by ensuring that the undistributed income of a CFC is taxed in the hands of domestic shareholders rather than being deferred to a foreign jurisdiction with a beneficial tax regime.[174] A CFC is defined by section 9D(1) as:

> "*any foreign company where more than 50 per cent of the total participation rights in that foreign company are directly or indirectly held, or more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable, by one or more residents of South Africa*."[175]

CFC legislation essentially aims to counter tax driven foreign investment and to avoid BEPS in South Africa. This CFC legislation taxes the resident shareholders rather than the CFC itself, therefore avoiding double taxation and giving effect to the intention of a DTA.[176]

Calculating the "net income" of a CFC involves treating the foreign company as a resident for specified sections of the Act, such as the Eighth Schedule containing capital gains tax provisions, [177] and as a taxpayer for other provisions not referencing resident status.[178] [KS4] Various exemptions, such as the designated country exception,[179] the business

[172] Pidduck 47.
[173] As above.
[174] Oguttu 2009 *The Comparative and International Law Journal of Southern Africa* 2.
[175] Section 9D(1) of the Income Tax Act.
[176] National Treasury "Detailed Explanation to section 9D of the Income Tax Act" 2002 2.
[177] Para 20(1)(h)(iii) of the Eighth Schedule.
[178] Section 9D(2A) of the Income Tax Act.
[179] Section 9D(9)(a) of the Income Tax Act.

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establishment exception,[180] the "already included" exception,[181] the related and intra-group exemption[182] and the participation exemption[183] aim to ensure fair taxation on income generated through foreign investments. The most widely used exemption is the foreign business establishment exemption, which provides that amounts attributable to a foreign business establishment are ignored for South African tax purposes.[184] SARS is increasingly initiating international tax reviews, alleging that South African registered companies and their overseas based or related companies have contravened section 9D, particularly by improperly claiming the foreign business establishment exemption.[185] The imposition of section 46 of the Tax Administration Act grants SARS wide discretionary authority to request taxpayers or other relevant parties to submit the necessary materials needed to carry out the administration of tax laws concerning a taxpayer.[186] This provision empowers SARS with the procedural tools to enforce compliance with Section 9D, and to ascertain whether a foreign business establishment exemption was improperly claimed.

Section 9D serves as proof that South African tax authorities are aware of the tax implications triggered by the globalisation of business entities and are making a concerted effort to protect the tax base whilst still allowing MNEs to be internationally competitive.

3.3.2 Section 31 of the Income Tax Act

Section 31 of the Income Tax Act addresses transfer pricing in South Africa. Transfer pricing is the price at which goods or services are exchanged between parties.[187] In a tax context, transfer pricing is of concern in situations where connected parties[188] manipulate the transfer price in cross-border transactions in order to take advantage of different tax jurisdictions that will provide a more desirable tax outcome. Section 31 requires taxpayers to evaluate whether the terms of a transaction, operation, agreement, or understanding align with what would have been agreed upon if the involved parties were independent

[180] Section 9D(9)(b) and (11) of the Income Tax Act.
[181] Section 9D(9)(e) of the Income Tax Act.
[182] Sections 9D(9)(f),(f)(A), and (B) of the Income Tax Act.
[183] Section 9D(9)(h) of the Income Tax Act.
[184] Section 9D(9)(b) of the Income Tax Act.
[185] SARS Tax Administration Bill 2010 para 2.2.5.
[186] Section 46(1) of the Tax Administration Act 28 of 2011.
[187] Olivier & Honiball (2011) 649.
[188] Section 1(1) and 31(4) of the Income Tax Act.

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and dealing at arm's length.[189] An arm's length price is a price negotiated on the open market between a willing buyer and a willing seller. If there is a discrepancy leading to a tax benefit for the taxpayer involved, they must adjust their taxable income according to the terms expected in an arm's length transaction.[190] The onus is on taxpayers to self-assess what should have transpired on an arm's length basis in respect of affected transactions when submitting their own tax returns and to compare this with the actual result of their "affected transaction".[191] Many MNE's involved in treaty shopping do not abide with the arms-length rule. The interconnectivity between MNE's and other large corporations often means that transactions between them are not reflective of their true economic value.[192]

Thin capitalisation is one such tactic used by connected parties to minimise their tax liabilities, and occurs where a company relies heavily on debt financing rather than equity financing, resulting in a high debt-to-equity ratio.[193] A taxpayer that is financed through debt may become entitled to deduct interest payments that have been incurred in the production of income. Contrastingly, a taxpayer that is financed through equity will not become entitled to deduct any dividends or returns on capital.[194] Section 24J of the Act defines interest to include various items, one of which is the "*gross amount of any interest or related finance charges, discounts, or premiums that are payable or receivable under or in relation to a financial arrangement*."[195]

It is clear from the above that SARS has a stake in ensuring that the South African tax base is not depleted by taxpayers with excessive intra-group, back-to-back or intra-group guaranteed debt which may result in excessive interest deductions.[196] Section 31 of the Act has the effect that, in cases where a foreign shareholder provides financial assistance, such as a loan, to a South African subsidiary and the loan is considered

[189] Section 31(1) of the Income Tax Act.
[190] Section 31(2)(b)(ii) of the Income Tax Act.
[191] Section 31 (1) of the Income Tax Act.
[192] Olivier & Honiball (2011) 649.
[193] Oguttu *International Tax Law: Offshore Tax Avoidance in South Africa* (2015) 213-215.
[194] Stiglingh *et al* Silke *South African Income Tax* (2020) 544.
[195] Section 24J(a) of the Income Tax Act.
[196] Section 23M and 23N of the Income Tax Act.

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"excessive" in relation to the equity contributed by that shareholder, the interest deductible by the South African company on such loan is limited to an arm's length amount.[197]

South Africa's transfer pricing legislation are designed to comply with international standards and guidelines, particularly those set out in the OECD BEPS Action 9, which focus on ensuring that transfer pricing outcomes are in line with value creation, aiming to prevent the artificial shifting of profits to avoid taxation.[198]

3.3.3 Section 23M and section 23N of the Income Tax Act

Sections 23M and 23N of the Act include specific anti-avoidance provisions that can restrict interest deductions once Section 31 has been applied. Section 23M is applicable only to transactions that are not covered by Section 23N, as is clear from the wording of the Income Tax Act.[199]

Section 23M of the Act, aims to limit the aggregate deductions for interest that is not subject to tax in the hands of the recipient if a controlling relationship exists between the debtor and the creditor,[200] except where the interest is included in the income of a CFC in the foreign tax year in which the interest deduction is claimed by the debtor.[201] Under section 23M, a debtor is defined as either a resident individual or a non-resident individual who maintains a permanent establishment within the Republic and has debt claims tied to that establishment.[202] This clause primarily targets limiting the deductibility of payments made either by South African tax residents or from revenues that are subject to tax in South Africa. Its purpose is to safeguard the South African tax base. Interest is subject to tax in the form of a withholdings tax on interest. Interest withholding tax may be levied at a rate of 15% in respect of interest paid or due and payable to a non-resident,[203] subject to the application of a DTA concluded between South Africa and the foreign jurisdiction.[204] In instances where a DTA provides the foreign jurisdiction with the exclusive taxing rights

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[197] Section 31(4) of the Income Tax Act.
[198] OECD/G20 "Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports" (2015) 9.
[199] Section 23N of the Income Tax Act.
[200] Section 23M (1) of the Income Tax Act.
[201] Section 23M (2) of the Income Tax Act.
[202] Section 23M (1) of the Income Tax Act.
[203] Section 50A-50H of the Income Tax Act determines the withholding tax on interest.
[204] Section 23M(2) of the Income Tax Act.

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in respect of South African sourced interest income derived by an offshore company, no South African withholding tax would be triggered by the South African Company.[205] As the holding company would in such circumstances not be subject to South African tax in respect of its interest income, the interest deduction limitation in section 23M may be applicable.[206]

Section 23N of the act pertains to the limitation of interest in respect of reorganisation[207] and acquisition transactions[208] and places its primary focus on debt obligations to related parties such as parent companies, subsidiaries, or entities sharing common ownership.[209]

Within this framework, Section 23N(3) establishes a crucial debt-to-equity ratio that South African entities must strictly adhere to. This ratio generally stipulates that the debt component, consisting of borrowings within a company's capital structure, should not surpass a specified percentage of its equity, represented by shareholder funds.[210] If, however, the debt component exceeds the predetermined threshold, any interest expense incurred on the excess debt may lose its eligibility for tax deduction within the South African tax framework.[211] The precise threshold for this debt-to-equity ratio can exhibit variability and is typically determined by SARS. Furthermore, Section 23N holds the capacity to re-characterise the interest disallowed due to excessive debt as a deemed dividend. In practical terms, this implies that any interest expense rendered non-deductible is treated as a distribution of profits to the related-party lender.[212] Such distributions may then become subject to dividend withholding tax.[213] This percentage can be as high as 25% on deemed donations exceeding R30 million.[214]

[205] As above.
[206] Section 23M (ii) of the Income Tax Act.
[207] Section 45 and Section 47 of the Income Tax Act pertain to reorganisation transactions.
[208] Section 24O (a) and (b).
[209] Section 23N (1) of the Income Tax Act.
[210] Section 23N (3) of the Income Tax Act.
[211] Section 23N (2)(d) of the Income Tax Act.
[212] Sections 8F and 8FA of the Income Tax Act re-characterise interest income and expenditure where taxpayers attempt to disguise equity instruments as debt instruments in order to benefit from an interest deduction.
[213] Sections 64D to 64N of the Income Tax Act.
[214] Section 64(1) of the Income Tax Act.

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Sections 23M and 23N are in line with the OECD BEPS Action 4 recommendations, which focus on limiting base erosion involving interest deductions and other financial payments.[215]

3.3.4 Section 35 of the Tax Administration Act 28 of 2011

Section 35 of the TAA tackles treaty shopping and inappropriate tax avoidance through the enforcement of reporting obligations. Parties involved in what are termed "reportable arrangements" are required to disclose transaction details to SARS within 45 business days, enabling SARS to detect and address issues promptly.[216] Non-compliance results in penalties and interest, acting as strong disincentives against treaty shopping and tax avoidance.[217]

Reportable transactions encompass transactions or schemes that could potentially come under the purview of the GAAR.[218] When SARS investigates a transaction or arrangement suspected of being an impermissible tax avoidance arrangement, as defined in section 80A of the act, the disclosed details can shed light on the taxpayer's intentions and the commercial substance of the arrangement, thereby bolstering the case for applying GAAR if necessary.[219]

The existence of reporting obligations under Section 35 empowers SARS to assess cross-border transactions effectively, helping identify treaty shopping and general tax avoidance concerns.[220] Taxpayers are more inclined to structure their affairs in a compliant manner when they know that certain arrangements must be disclosed to SARS. This could lead to greater adherence not only to the letter but also to the spirit of tax laws, potentially diminishing the need for GAAR interventions.[221]

[215] OECD/G20 Base Erosion and Profit Shifting Project "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report" (2015).
[216] The list of transactions that must be reported are set out in s35(1) of the TAA, and in s35(2) of the TAA as read with a SARS notice issued pursuant to that provision.
[217] Section 37(1)(b) of the Tax Administration Act.
[218] Sections 80A - 80L of the Income Tax Act.
[219] Section 80A(a)(ii) introduces the lack of commercial substance test, only applicable in business arrangements and considered with section 80C of the Income Tax Act.
[220] Section 37(1)(b) of the Tax Administration Act.
[221] Oosthuizen and Thiart "A critical analysis of the foreign services reportable arrangement provision of the Tax Administration Act of South Africa" 2020 *South African Journal of Economic and Management Sciences* 10.

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In essence, the reporting obligations contained in Section 35 of the TAA are pivotal in bolstering the administration and enforcement of tax laws in South Africa, including the effective implementation of GAAR.[222]

3.4 The Draft Tax Administration Laws Amendment Bill 2023 – APA Programme Proposal

South Africa has taken a significant step in enhancing its tax administration system by introducing a proposal to implement an APA programme, in line with the OECD BEPS Action 9 recommendations.[223] This development was unveiled through the release of the Draft Tax Administration Laws Amendment Bill on July 31, 2023.[224] The purpose of an APA programme is to provide a mechanism for MNEs and tax authorities to proactively establish agreed-upon transfer pricing methodologies and principles for cross-border transactions.[225] APAs are used to prevent and resolve potential transfer pricing disputes and uncertainties related to the pricing of goods, services, or intangible assets exchanged between related entities within an MNE group.[226]

The South African APA programme, initially focusing on bilateral APA applications, signifies a prudent approach aimed at building experience before venturing into multilateral APA applications.[227]This cautious strategy allows South Africa to benefit from the experiences of other jurisdictions that have successfully implemented APA programs and establish a controlled learning curve. It also enables SARS to gradually refine and expand its capacity to meet future demands.[228] Notably, the APA framework emphasises collaboration with affected treaty partners at crucial stages of the process, underlining

[222] Section 35(2) of the Tax Administration Act.
[223] OECD/G20 "Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports" (2015).
[224] The Draft Tax Administration Laws Amendment Bill 2023 para 10.
[225] EY "South Africa proposes an Advance Pricing Agreement (APA) program" https://www.ey.com/en_gl/tax-alerts/south-africa-proposes-an-advance-pricing-agreement--apa--program#:~:text=An%20APA%20program%20will%20provide,that%20have%20transfer%20pricing%20implications Published 1st August 2023 (accessed 30 October 2023).
[226] As above.
[227] SARS "Proposed model for establishing an Advance Pricing Agreement Programme in South Africa and release of draft legislation" (2022) 5.
[228] As above.

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South Africa's commitment to international standards and its dedication to fostering cooperative relationships with partner states.[229]

APAs serve as a valuable tool to create a win-win situation for both MNEs and tax authorities. They reduce uncertainty, promote compliance, and facilitate a cooperative approach to transfer pricing matters, ultimately contributing to a fair and efficient international tax system.[230]

3.5 The substance over form

The substance over form doctrine is a common law principle that forms an important part of South African law and is instrumental in dealing with instances of simulation.[231] The doctrine is founded on the principle that the law regards the substance rather than the form of things.[232]When applied in tax transactions the substance over form principle empowers the court to ignore the simulated transaction that appears to legitimise a taxpayer's claims for a tax benefit and give effect to the real transaction.[233]

SARS can challenge a simulated transaction or business structure, such as a conduit company, in terms of common law and will not necessarily have to invoke the GAAR.[234] If SARS is satisfied that the intention behind a specific transaction is different to that of the appearance of the transaction, the transaction can be deemed to be taxed according to the true substance and intention of the transaction rather than the legal form thereof.[235]

However, if the doctrine cannot be applied, since the form of an arrangement is identical to the substance thereof, the courts may use the GAAR to curb impermissible tax avoidance.[236]

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[229] The Draft Tax Administration Laws Amendment Bill 2023 paras 15-20.
[230] SARS "Proposed model for establishing an Advance Pricing Agreement Programme in South Africa and release of draft legislation" (2022) 4.
[231] "*Simulation exists where there is a purported transaction which in reality is initiated without the intention to give effect to it or some of its terms, and the parties to the transaction have, in fact, an ascertainable and real agreement they intend to give effect to, despite what they purport to agree on."* See Williams *Income Tax in South Africa Cases and Materials* (2005) 562.
[232] *Dadoo Ltd & others v Krugersdorp Municipal Council* 1920 AD 530 547.
[233] Legwaila "The substance over form doctrine in taxation: the application of the doctrine after the judgment in *Commissioner for the South African Revenue Service v NWK Ltd*" 2016 *SA Merc LJ* 1.
[234] Legwaila 2016 *SA Merc LJ* 5.
[235] *Commissioner for the South African Revenue Service v NWK Ltd* para 42 and 54.
[236] Section 80A- 80L of the Income Tax Act.

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The principle of substance over form, as used in domestic anti-abuse clauses, can be legitimately applied to situations covered by a treaty if both contracting states recognize and apply this standard under their own domestic laws.[237]

3.6 Conclusion

The battle against impermissible tax avoidance through agreements or transactions is a top priority for SARS. South African income tax legislation employs both SAAR and GAAR, particularly Section 80A to L and section 103 of the Income Tax Act, aim to combat impermissible tax avoidance, focusing on tax benefit, abnormality, lack of commercial substance, rights at arm's length, and misuse of tax provisions. When specific conditions align, the GAAR comes into play. The GAAR provides the Commissioner with remedies to treat or adjust arrangements and requires taxpayers to demonstrate genuine commercial substance. Its limited judicial interpretation has sparked insightful discussions and prompted recommendations for enhancement.

The chapter explores SAARs, which are highly specific regulations designed to counteract tax avoidance in distinct situations. It highlights the necessity of a broader-reaching GAAR, which addresses tax avoidance across diverse scenarios.

In summary, this chapter offers a comprehensive exploration of the application of South African GAAR and SAAR emphasising the imperative distinction between legal and factual aspects in GAAR-related disputes. It advocates for continued amendments to the GAAR, the introduction of penalties or fines for taxpayers engaged in impermissible avoidance arrangements and underscores South Africa's commitment to combat tax avoidance and protect its tax base. Ongoing discussions, court cases, and academic analysis contribute to the continuous refinement of the state’s anti-avoidance regulations.

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[237] Oguttu “Curbing 'treaty shopping': the 'beneficial ownership' provision analysed from a South African perspective” 2007 *Comparative and International Law Journal of Southern Africa* 14.

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Chapter 4: Regulation of treaty shopping by International Tax Agreements

4.1 Introduction

South Africa boasts the most extensive tax treaty network in Africa,[238] encompassing a range of provisions designed to regulate treaty shopping. These provisions typically include measures to prevent treaty abuse, such as anti-avoidance rules, beneficial ownership requirements, and provisions related to the limitation of benefits. As an OECD observer majority of South Africa's treaties are based upon the OECD Model Tax Convention ("OECD Model"). South Africa actively participates in the OECD BEPS project, which is a global initiative led by the OECD and supported by the G20 (of which South Africa is a member).[239]

This chapter discusses the provisions that South Africa has chosen to implement in their international tax agreements in respect of treaty shopping and the effectiveness thereof. Where these provisions are found to be ineffective, the study makes recommendations.

4.2 Background

In South Africa's tax treaty history, the period leading up to 1994 was characterised by a limited number of tax treaties, primarily with African nations.[240] This era coincided with the states international isolation due to apartheid policies, resulting in restricted engagement with global organisations, including the OECD.[241] However, in the post-1994 era following the end of apartheid and the establishment of a democratic government,

[238] SARS "Overview of International Agreements" 18 https://static.pmg.org.za/140827sars.pdf (accessed 30 May 2023).
[239] The Group of Twenty (G20) is the premier forum for international economic cooperation. It plays an important role in shaping and strengthening global architecture and governance on all major international economic issues; See https://www.g20.org/en/about-g20/ (accessed 10 October 2023).
[240] Katz Commission 5th Report (1999) "South African History and Background" in *Basing the South African Income Tax System on the Source or Residence Principle – Options and Recommendations* 6.
[241] Katz Commission 5th Report (1999) "Treaty Negotiations" in *Basing the South African Income Tax System on the Source or Residence Principle – Options and Recommendations* 13.

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South Africa embarked on a path of renewed international involvement.[242] A notable development during this period was the significant expansion of South Africa's tax treaty network.[243] This expansion was a strategic move by the government to stimulate foreign investment and international trade by mitigating the risk of double taxation for individuals and businesses engaged in cross-border operations.[244]

In 2014, the OECD launched its BEPS Action Plan, initially comprising 7 Actions and later expanding to 15 Actions,[245] with the overarching goal of combating tax avoidance, enhancing the consistency of international tax regulations, and promoting greater transparency in the global tax landscape.[246] South Africa has actively participated in the OECD/G20 BEPS project, which is designed to tackle tax avoidance by MNEs. As part of its engagement with the BEPS project, South Africa has proactively integrated BEPS measures into its tax treaties, aligning its practices with international norms to mitigate profit shifting and prevent treaty abuse.[247]

4.3 The OECD MLI

Before looking at the various OECD Provisions and Actions South Africa adheres to, it is important to note that on the 7th of June 2017, South Africa joined over 100 other jurisdictions in signing the OECD MLI.[248] The MLI streamlines the implementation of tax treaty-related measures to combat BEPS in existing bilateral tax treaties. Treaty partners that have ratified the MLI automatically adopt these tax-related BEPS measures, eliminating the need for individual renegotiations of existing bilateral tax treaties.[249] These

[242] As above.
[243] Katz Commission 5th Report (1999) "South African History and Background" in *Basing the South African Income Tax System on the Source or Residence Principle – Options and Recommendations* 7.
[244] As above.
[245] OECD BEPS Action Plan https://www.oecd.org/tax/beps/beps-actions/ (accessed 7 November 2022)
[246] As above.
[247] OECD "South Africa and the OECD" https://www.oecd.org/southafrica/south-africa-and-oecd.htm#:~:text=South%20Africa%20participates%20as%20an,the%20Economic%20Policy%20Committee%2C%20the (accessed 7 May 2023).
[248] OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm (accessed 10 May 2023).
[249] As above.

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measures aim to prevent treaty abuse,[250] enhancing dispute resolution,[251] curbing artificial avoidance of permanent establishment status,[252] and addressing the effects of hybrid mismatch arrangements.[253] South Africa's instrument of ratification for the MLI was issued on September 30, 2022, and the MLI came into force in South Africa on January 1, 2023.[254] A discussion on the automatically adopted BEPS measures pertaining to the prevention of treaty shopping is below.

4.4 GloBE Rules – Pillar Two

The GloBE rules are part of the two-pillar solution developed to update the key elements of the international tax system so that it is more effective in a globalised and digitalised economy.[255] The South African Treasury confirmed that during the 2023 legislative cycle, the government will publish a draft position on the implementation of the Pillar Two global minimum tax for public comment and draft legislation will be prepared for inclusion in the 2024 Taxation Laws Amendment Bill.[256]

These rules aim to address issues related to international taxation, primarily focused on ensuring that MNEs pay a minimum level of tax, even in cases where they engage in aggressive tax planning or take advantage of low-tax jurisdictions.[257] GloBE rules aim to reduce tax competition amongst states, ultimately preventing treaty shopping and profit shifting to low-tax or no-tax jurisdictions.[258]

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[250] Part 3 of the OECD "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (2016).
[251] Part 5 of the OECD "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (2016).
[252] Art 10 and 12 of the OECD "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (2016).
[253] Part 2 of the OECD "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (2016).
[254] In terms of s108(2) of the Income Tax Act 1962, read in conjunction with s231(4) of the Constitution of the Republic of South Africa 1996.
[255] OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021) https://doi.org/10.1787/782bac33-en (accessed 12 September 2023).
[256] National Treasury 2023 Budget Review https://www.treasury.gov.za/documents/National%20Budget/2023/budgetReview.aspx (accessed 20 0ctober 2023).
[257] Art 1 of the OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021).
[258] OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021) 61.

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Pillar 2 introduces a concept known as the "Global Minimum Tax." Under this proposal, participating states agree to set a minimum effective tax rate that MNEs must pay on their income.[259] This rate is usually above the lowest tax rates in any state to prevent tax avoidance. If an MNE pays tax in a foreign jurisdiction at a rate lower than the agreed-upon minimum, the home state can impose a "top-up tax" to ensure the income is taxed at the minimum rate.[260]

To combat treaty shopping, Pillar 2 includes a "subject to tax rule." This rule specifies that certain deductible payments, such as royalties and interest, made by an entity in one state to an entity in another state are only deductible if they have been subject to tax at or above the minimum rate.[261] This ensures that income is not shifted to jurisdictions with no or minimal taxation. In addition to the subject to tax rule, Pillar 2 introduces the "undertaxed payment rule" which allows a state to impose withholding taxes on certain payments made to low-tax or no-tax jurisdictions to ensure that the effective tax rate on these payments meets or exceeds the minimum rate.[262]

Pillar 2 ensures that MNEs pay their fair share of taxes, regardless of where they conduct their business activities, ultimately promoting a more equitable and stable international tax system.[263]

4.5 BEPS Action 5 - Harmful tax practices

BEPS Action 5 targets harmful tax practices, emphasising transparency and information exchange regarding certain tax regimes that facilitate treaty shopping and erode the tax base of other states.[264] This action establishes a framework to identify and address preferential tax regimes that may give rise to harmful tax practices and requires states to make commitments to improve transparency and align their tax regimes with international

[259] As above.
[260] Art 2.2 of the OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021).
[261] OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021) 40.
[262] Art 2.5 of the OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021).
[263] OECD "Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)" (2022) 3.
[264] OECD/G20 Base Erosion and Profit Shifting Project "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report" (2015) 5.

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standards.[265] States are required to perform reviews of their tax regimes and provide detailed information about any regimes that have features indicative of harmful tax practices. This information is shared with other states through a comprehensive transparency framework.[266] South Africa is compliant with the recommendations of Action 5, and has international agreements permitting spontaneous exchange of information, including being a party to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[267] South Africa is also not currently considered to have a harmful tax regime in terms of the 2023 OECD review.[268]

4.6 BEPS Action 6 - Prevention of tax treaty abuse

Action 6 focuses on preventing the inappropriate granting of treaty benefits and addresses treaty shopping through three provisions that contracting states can implement in their DTAs.[269] These provisions include a PPT with either a simplified or detailed LOB rule, the PPT alone, or a detailed LOB rule along with a mechanism (like a PPT rule restricted to conduit arrangements or domestic anti-abuse rules) to deal with conduit arrangements not covered in tax treaties.[270]

South Africa, upon signing the OECD MLI, chose to implement the PPT rule alone as a strategic move against treaty shopping and tax avoidance.[271] The PPT serves as an anti-abuse provision, aligning with global standards and reflecting a commitment to the BEPS project.[272] South Africa's compliance with OECD recommendations, as outlined in

[265] OECD/G20 Base Erosion and Profit Shifting Project "Revamp of the work on harmful tax practices: Framework for improving transparency in relation to rulings" in *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report* (2015) 45.
[266] As above.
[267] OECD/Council of Europe "The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol" (2011) https://dx.doi.org/10.1787/9789264115606-en (accessed 11 November 2023).
[268] OECD South Africa https://www1.compareyourcountry.org/tax-cooperation/en/2/626/default (accessed 11 November 2023).
[269] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) 9.
[270] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) para 19.
[271] OECD "Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" (2023) https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf (accessed 10 October 2023).
[272] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) para 19.

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paragraphs 22 and 23 of the Action 6 Final Report, is manifested in the express statement within the preamble of the 2017 OECD Model Tax Convention.[273] This statement reflects the common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through evasion, including treaty shopping.[274] The action also establishes a framework for dispute resolution, typically found in the MAP provisions of DTAs, promoting consistency in their application across states.[275] South Africa's DTAs align with Article 25 of the OECD Model Tax Convention, by providing a basis for MAP.[276] This strategic alignment not only fortifies South Africa's tax framework against abuses but also strengthens international cooperation by ensuring that its treaty network is robust, transparent, and fair.

4.7 The beneficial ownership provision

A beneficial ownership provision is a clause that is sometimes included in DTAs to ensure that the benefits of the DTA are granted to individuals or entities that are the actual beneficial owners of the income, rather than those who may be using complex ownership structures or legal arrangements to avoid or minimise tax.[277] In the South African context, the beneficial ownership provision in DTAs is significant because it helps prevent treaty abuse, especially in cases of dividend, interest, and royalty payments. South Africa has incorporated such provisions in its DTAs to protect its tax base and ensure that the benefits of the treaties are enjoyed by legitimate investors or businesses.[278]

The use of the beneficial ownership provision in DTAs as a measure to curb treaty shopping has indeed been a subject of discussion, confusion, and contention among both OECD and non-OECD member states. This is primarily due to the absence of a

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[273] OECD Model Tax Convention 2017.
[274] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) para 66.
[275] As above.
[276] SARS "Guide on Mutual Agreement Procedures" (2018) 12 https://www.sars.gov.za/wpcontent/uploads/Ops/Guides/LAPD-IT-G24-Guide-on-Mutual-Agreement-Procedures.pdf (accessed 15 June 2023).
[277] Oguttu 2007 *The Comparative and International Law Journal of Southern Africa* 8.
[278] Davis Tax Committee "Second interim report on base erosion and profit shifting (BEPS) in South Africa" (accessed 4 April 2023) 96.

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universally accepted, explicit definition of "beneficial ownership" in the OECD Model Tax Convention and its accompanying Commentary.[279]

Article 3(2) of the OECD Model Tax Convention permits states to apply the domestic meaning of a term that is not fully defined in the OECD Model Tax Convention and its Commentary and states that:

> "*the meaning of the term beneficial ownership that should prevail over any meaning given to the term under the other laws of a state is the tax law meaning of the term*."[280]

South African tax law has not provided a definition for the term "beneficial ownership" however, the concept of beneficial ownership is used in various pieces of legislation, especially in the context of taxation and anti-money laundering regulations. The precise definition and application of beneficial ownership may vary depending on the specific law or regulation in question. For example, in section 64D of the Income Tax Act the term "beneficial ownership" is defined, specifically in relation to dividends to mean "*a person entitled to the benefit of the dividend attaching to a share*".[281] This is a very vague definition and no guidance regarding its interpretation has been provided in the accompanying Explanatory Memorandum. The definition applies only for purpose of the Dividends Tax provisions of the Income Tax Act.

Regrettably, the term "beneficial ownership" lacks a universally defined meaning within the domestic tax laws of most states. Consequently, the interpretation of this concept by domestic courts has become a topic of significant debate, resulting in judicial discrepancies worldwide.[282]

The efficacy of the beneficial ownership provision in countering treaty shopping has been a matter of ongoing discussion and apprehension. This issue has been further complicated by various international cases that underscore the intricate nature of interpreting the term "beneficial ownership" and the divergent perspectives adopted by

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[279] Oguttu 2007 *The Comparative and International Law Journal of Southern Africa* 16.
[280] Article 3(2) of the OECD MTC.
[281] Act 58 of 1962.
[282] Oguttu 2007 *The Comparative and International Law Journal of Southern Africa* 16.

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different jurisdictions. Two key cases, *Prevost Car Inc. v Her Majesty the Queen* (the Prevost case)[283] in Canada and *Indofood International Finance Ltd v JP Morgan Chase Bank* (the Indofood case)[284] in the UK, shed light on the challenges associated with this provision.

In the Prevost case, the issue revolved around a Canadian company, Prevost Car Inc., owned by Swedish and UK residents through a Dutch holding company (HoldCo). The question was whether the Dutch holding company, DutchCo, could be considered the beneficial owner of dividends received from Prévost for treaty relief purposes. The Canadian court determined that DutchCo qualified as the beneficial owner based on its control over the dividends, emphasizing that beneficial ownership relates to the recipient's control and use of the income.

The *Prevost* case followed a formalistic approach, focusing on corporate governance and the intermediary's actual management.[285]

In the *Indofood* case, the dispute arose from a contract between Indofood International Finance Ltd, an Indonesian company, and UK bank JP Morgan as trustee for bondholders. Indofood aimed to issue loan notes on the international market while avoiding Indonesia's 20% withholding tax on interest payments.[286] To achieve this, a subsidiary was established in Mauritius, taking advantage of the tax treaty between Mauritius and Indonesia, which imposed a lower 10% withholding tax. However, when Indonesia terminated the tax treaty, Indofood sought early redemption of the loan notes, which JP Morgan initially refused. The UK court analysed whether the Netherlands conduit company (used to circumvent the increased withholding tax) qualified as the beneficial owner under the Netherlands/Indonesia treaty.[287] The court relied on OECD Commentary, emphasising that a conduit company cannot be the beneficial owner if it lacks practical control and direct benefit from the income.

[283] *Prevost Car Inc v Her Majesty the Queen* 2008 TCC 231.
[284] *Indofood International Finance Ltd v JP Morgan Chase Bank NA* (2006) EWCA Civ 158.
[285] Avi-Yonah and Reuven (2010) 17.
[286] *Indofood v JP Morgan* para 42.
[287] *Indofood v JP Morgan* para 44.

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The key distinction between *Indofood* and *Prevost* is that in Indofood, a finding of no beneficial ownership of the intermediary allowed *Indofood* to redeem the notes early. In *Prevost*, a finding of beneficial ownership preserved the reduced withholding taxes.[288] These cases illustrated the divergent approaches taken by courts when interpreting beneficial ownership, showcasing the lack of a universally accepted definition.[289]

Furthermore, in the context of South Africa, Section 233 of the Constitution requires courts to prefer interpretations consistent with international law.[290] The interpretation of the beneficial ownership clause in a DTA should consider foreign case law, relevant legislation, and the specific context.[291] While the beneficial ownership clause may have utility in source taxation of specific income types,[292] it remains problematic for addressing treaty shopping due to its ambiguity and varying interpretations across jurisdictions. Therefore, it is crucial for South African courts to consider these complexities when applying the beneficial ownership clause in DTAs. The OECD Commentary can provide valuable guidance in this regard, but it may not eliminate the inherent challenges associated with the term.[293]

4.8 Conclusion

This chapter underscores South Africa's unwavering commitment to tackling treaty shopping and tax avoidance within its DTAs, as evidenced by their active engagement in the OECD BEPS project. The chapter outlines key findings, highlighting South Africa's strategic expansion of its tax treaty network, a move that aimed to stimulate foreign investment while preventing double taxation for entities involved in cross-border operations. Moreover, the study emphasises the significance of South Africa's adoption and ratification of the OECD MLI, aligning its tax treaties with international standards to counter treaty shopping and related tax avoidance practices. The chapter also addresses the impact of Pillar 2 of the BEPS project, which introduces the Global Minimum Tax and

[288] Avi-Yonah and Reuven (2010) 18.
[289] Davis Tax Committee "Second interim report on base erosion and profit shifting (BEPS) in South Africa" (accessed 4 April 2023) 4.
[290] The Constitution of the Republic of South Africa.
[291] As above.
[292] As is supported by Article 10(2) of the OECD Model Convention.
[293] OECD "Commentaries on the articles of the Model Tax Convention" https://www.oecd.org/berlin/publikationen/43324465.pdf (accessed 7 March 2023).

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measures against treaty shopping, further strengthening South Africa's resolve against profit shifting to low-tax jurisdictions. The study acknowledges the complexities of the beneficial ownership provision and recommends that South African courts consider these nuances when applying the provision in DTAs. South Africa's proactive engagement with international tax regulations solidifies its role as a key player in the global quest for a fair and effective international tax system.

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Chapter 5: The US Regulation of Treaty-Shopping

5.1 Introduction

The US began expressing its objections to treaty shopping in the context of international taxation in the early 1960s and remains one of the most vocal opponents of this practice today.[294] With approximately 68 DTA's in place worldwide and its own US Model Tax Treaty, the US shows their commitment to the reduction of double taxation and the prevention of aggressive tax planning within their nation.[295]

This chapter assesses US domestic laws, judicial doctrines, and the US Model tax treaty in the context of preventing treaty shopping. It serves as a comparative study for South Africa, exploring potential lessons and insights for addressing treaty shopping practices based on the US experience.

5.2 Specific Anti-Avoidance Rules

US SAAR's are mainly present in the Internal Revenue Code ("IRC"),[296] which has been largely amended by the Tax Cuts and Jobs Act ("TCJA").[297]

The rules that will be discussed are:

5.2.1 Section 59A of the IRC - Base Erosion Anti-Abuse Tax ("BEAT")

BEAT is a minimum corporate tax primarily targeting large MNEs that have substantial operations in the US known for engaging in BEPS practices.[298]

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[294] Reinhold "What is tax treaty abuse? (Is treaty shopping an outdated concept?)" 2000 *The Tax Lawyer* 663.
[295] IRS United States Income Tax Treaties - A to Z https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z (accessed 17 May 2023).
[296] Internal Revenue Code of 1986.
[297] Act 2017.
[298] IRS "IRC 59A Base Erosion Anti-Abuse Tax Overview" (2021) https://www.irs.gov/pub/irs-utl/irc59a-beat-overview.pdf (accessed 14 June 2023).

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To be subject to BEAT, two key thresholds must be met. The first is the "Gross Receipts Threshold", which requires a taxpayer to have average annual gross receipts of at least $500 million over a three-year period, thus identifying large corporations.[299]The second is the "Base Erosion Percentage Threshold", this threshold calculates the percentage of certain deductible payments to foreign related parties ("FRPs")[300] in relation to total US deductions. If these base erosion tax benefits represent 3% or more of deductions, BEAT may apply.[301] When both thresholds are satisfied, BEAT becomes applicable, acting as a minimum tax.

BEAT is designed to limit MNEs' ability to erode the US tax base through deductible payments to FRPs, regardless of their international tax planning strategies.[302] BEAT serves as a safeguard to prevent MNEs from excessively reducing their US tax liability through transactions with FRPs.[303] This ensures that tax revenue is maintained, discourages abusive tax practices, and creates a level playing field for domestic businesses.

5.2.2 Section 482 of the IRC - Transfer Pricing Rules

Section 482 of the IRC pertains to transfer pricing regulations, with the primary goal of ensuring that taxpayers accurately reflect income associated with "controlled transactions".[304] This measure is in place to prevent tax avoidance within related entities and to establish a "controlled taxpayer"[305] on an equal footing with an "uncontrolled taxpayer" by adhering to the arm's-length principle.[306]

The US Treasury has established clear guidelines for implementing transfer pricing rules under Section 482 of the IRC.[307] These regulations outline specific methodologies for

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[299] Section 59 A(e)(1)(B) of the IRC.
[300] Section 59 A(f) and section 7701 of the IRC defines a "foreign related party" as a "*foreign person that is a related party with respect to the taxpayer. A foreign person is any person who is not a "U.S. person" as defined under IRC 7701(a) (30), except that any individual who is a citizen of any US possession (but not otherwise a US citizen); and who is not a US resident is not a US person*."
[301] Section 59A(c)(4)(A) of the IRC.
[302] IRS 2021 "IRC 59A Base Erosion Anti-Abuse Tax Overview" (accessed 14 June 2023).
[303] As above.
[304] Section 482 (1)(a) of the IRC.
[305] Section 482 (a)(4) of the IRC.
[306] Section 482 (b)(1) of the IRC.
[307] Section 1.482-3 of the Treasury Regulations under the IRC.

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determining fair prices for tangible goods and intangible property. The Comparable Uncontrolled Price ("CUP") Method compares prices in controlled transactions with those in similar uncontrolled transactions.[308] The Resale Price Method compares the resale price to an unrelated party with prices in independent sales of similar products.[309] The Cost Plus Method involves marking up costs to determine an arm's length price, reflecting the profit an independent entity would expect.[310] The Comparable Profits Method compares taxpayer profits with those of independent enterprises in similar transactions.[311] Lastly, the Comparable Uncontrolled Transaction ("CUT") Method focuses on intangible property, comparing controlled and uncontrolled transactions involving similar intangibles.[312] The specificity of the abovementioned methods minimises room for manipulation or treaty shopping, as it outlines transparent standards and procedures. These transfer pricing rules aim to ensure the accurate reflection of income in controlled transactions, thus preventing profit shifting typically associated with treaty shopping.

Section 482 of the IRC mandates taxpayers to provide comprehensive documentation for transfer pricing, ensuring compliance with the arm's length standard.[313] This documentation helps tax authorities identify and challenge treaty shopping strategies aimed at shifting profits. It also requires a comparability analysis to ensure related-party transactions align with market conditions and don't exploit tax treaty provisions.[314]

Non-compliance with Section 482 can result in IRS penalties, audits, and adjustments. Penalties are a percentage of the IRS adjustment to the taxpayer's income. Audits review transfer pricing policies and documentation for arm's length compliance.[315] If controlled transactions don't meet the standard, the IRS may adjust income, increasing tax liability.[316] Alongside penalties and adjustments, interest charges on underpaid taxes may apply, accruing from the tax return due or filing date until the underpaid amount is settled.

[308] Section 1.482-3 of the Treasury Regulations under the IRC.
[309] Section 1.482-1(d) of the Treasury Regulations under the IRC.
[310] Section 1.482-9 (e)of the Treasury Regulations under the IRC.
[311] Section 1.482-6 of the Treasury Regulations under the IRC.
[312] Section 1.482-1(d) of the Treasury Regulations under the IRC.
[313] Section 1.482-1(d)(4)(i)(A),(B) and (C) of the Treasury Regulations under the IRC.
[314] Section 1.482-1(c)(2)(i) of the Treasury Regulations under the IRC.
[315] Section 6662 of the IRC.
[316] Section 6601 of the IRC.

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Section 482 of the IRC prevents treaty shopping by enforcing the arm's length principle and requiring proper documentation. It promotes transparency, minimises profit-shifting opportunities, and enables US tax authorities to challenge tax avoidance in related-party transactions. This safeguards fair tax contributions from companies, preserving the integrity of the US tax system.

5.2.3 Limitation of Hybrid Entities - Section 267A and 245A of the IRC

Sections 267A and 245A of the IRC, modified by the TCJA in 2017, collaboratively tackle treaty shopping by addressing "hybrid arrangements." A hybrid transaction is defined as:

> *"any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for US tax purposes but are not so treated for purposes of the tax law of a specified recipient of the payment."*[317]

The amendments made by the TCJA are integral to broader initiatives aimed at preventing MNEs from leveraging tax law disparities between states for advantages like double deductions or exclusions. Aligned with OECD BEPS Action 2, which aims to neutralise the effects of hybrid mismatch arrangements,[318] these IRC changes contribute to global tax fairness, by diminishing opportunities for MNEs to engage in tax avoidance, and maintaining the integrity of the US tax system in harmony with international efforts against BEPS.

Section 245A introduces the participation exemption system, transitioning US taxation from a global to a territorial system.[319] Unlike global taxation, where US corporations are taxed on worldwide income, a territorial system taxes them solely on income within the states borders.[320] This shift aligns the US with international norms, reducing the risk of double taxation and enhancing global competitiveness.[321] Section 245A(e) addresses

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[317] Section 1.267A-2(2) of the Treasury Regulations under the IRC defines hybrid transactions.
[318] OECD/G20 Base Erosion and Profit Shifting Project "Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report" (2015).
[319] Section 245A of the IRC.
[320] The US shifted to a territorial tax system as part of the 2017 TCJA.
[321] Langenmayr & Liu "Home or Away? Profit Shifting with Territorial Taxation" 2022 *IMF Working Papers* 11.

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hybrid dividends, disqualifying the dividend received deduction to prevent undeserved tax benefits. Hybrid dividends involve payments with differing tax treatment in source and receiving states, potentially leading to double tax benefits.[322]This provision aims to curb tax mismatches and prevent treaty shoppers from exploiting hybrid financial arrangements.[323]

Section 267A targets interest or royalty deductions in hybrid transactions, restricting payments' deductibility in cases of differing tax treatments between the US and the taxpayer's residence jurisdiction.[324] By curbing tax mismatches, Section 267A levels the playing field and prevents treaty shoppers from exploiting variations in tax treatment.

5.2.4 Section 951A of the IRC - Global Intangible Low-Taxed Income ("GILTI")

GILTI serves a similar purpose to that of the GloBE rules[325] by providing for a minimum level of tax in the US on the foreign income of an MNE group.[326]

GILTI's primary objective is to tax the foreign earnings of US MNEs, even in cases where these earnings encounter minimal or no foreign taxation.[327] GILTI was adopted when the US moved from a worldwide tax system to a territorial tax system, and takes into account foreign income that is not effectively connected with a US trade or business, focusing primarily on income arising from intangible assets such as intellectual property.[328] GILTI's specific focus on intangible income is a critical component of its effort to prevent treaty shopping. By establishing complex corporate structures, MNEs can artificially allocate the income associated with patents, trademarks, copyrights, and other intellectual property to subsidiaries in states with favourable tax treaties.[329] GILTI requires US shareholders of CFCs to add the CFCs' income to their taxable income, regardless of whether the CFCs

[322] Section 245A(e) of the IRC.
[323] As above.
[324] Section 267A(7) of the IRC.
[325] OECD "Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)" (2021).
[326] Section 951A(a) of the IRC.
[327] Section 951A (f)(1) of the IRC.
[328] Bunn "U.S. Cross-border Tax Reform and the Cautionary Tale of GILTI" 2021 *The Tax Foundation* 3.
[329] Desai, Foley and Hines "The demand for tax haven operations" 2006 *Journal of Public Economics* 520.

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distribute earnings.[330] It focuses on US MNEs with foreign subsidiaries, promoting transparent reporting of foreign earnings and diminishing incentives for treaty shopping.

To prevent double taxation, the TCJA provides a deduction and a foreign tax credit mechanism to offset the US tax liability associated with GILTI income.[331] This alleviates the concern of US companies being taxed on the same income both in the foreign jurisdiction and in the US.

Overall, GILTI represents a significant step toward ensuring tax equality and discouraging strategies that exploit tax differences between jurisdictions.

5.2.5 Section 163(j) of IRC - Earning Stripping Rules ("ESR")

Earnings stripping is an MNE tax strategy to lower tax liability by moving profits from high-tax to low-tax jurisdictions.[332] It usually entails a related-party transaction, where a subsidiary in a high-tax state borrows from a parent or affiliate in a low-tax or tax haven. Interest payments on the loan create deductible expenses in the high-tax state, decreasing taxable income and overall tax owed. This allows for significant interest deductions without necessitating new US investments by the company.[333]

Section 163(j) indirectly impacts treaty shopping by restricting the deductibility of specific interest payments. It employs a fixed ratio approach to determine the maximum deductible interest on debt.[334] This provision generally limits the deduction for business interest expenses to the sum of business interest income, 30% of adjusted taxable income, and floor plan financing interest.[335] By constraining interest deductibility, including payments to related foreign entities, Section 163(j) prevents profit shifting to low-tax jurisdictions through excessive interest deductions. In 2017, the US Joint Committee on Taxation estimated that this limitation would boost US tax revenue by $8.4

330 Section 951A(c)(2)(A)(ii) of the IRC.
331 Section 960(a)-(e) of the IRC.
332 Leonard Teti "US Treasury Department Loosens "Earnings Stripping" Rules" 2019 (accessed 14 June 2023).
333 As above.
334 Section 163(j)(1) of the IRC.
335 Section 163(j)(B) and (C) of the IRC.

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billion in 2018 and around $253 billion from 2018 to 2027, illustrating its expected effectiveness in preserving and enhancing the US tax base.[336]

The US ESR align with OECD BEPS Action 4, focusing on limiting base erosion related to interest deductions and financial payments.[337] Although Section 163(j) primarily targets broader BEPS concerns, it also indirectly combats treaty shopping by curbing the tax advantages associated with interest payments in such arrangements. Through the restriction of interest expense deductibility, particularly in related-party transactions, this provision reduces the financial attractiveness of MNEs engaging in treaty shopping practices.[338]

5.3 The Economic Substance Doctrine

The US economic substance doctrine, a longstanding judicial principle, assesses the economic substance and primary purpose of a transaction for federal tax purposes.[339] This doctrine empowers tax authorities and courts to challenge or disregard tax benefits claimed under the IRC if a transaction lacks economic substance or is primarily aimed at tax avoidance.[340] Codified by section 7701(o) of the IRC in 2010, the economic substance doctrine introduced specific statutory requirements reinforcing its application.[341] These requirements involve a two-stage inquiry; firstly evaluating if the transaction had reasonable profit potential[342] and then determining if it had actual economic substance.[343] Courts may disregard transactions lacking economic substance, except for separable parts that pass the test.[344] The US IFA Report confirms the use of the substance over

[336] Joint Commission on Taxation "Estimated Budget Effects of the Conference Agreement for H.R 1- The Tax Cuts and Jobs Act" (2017) 3.
[337] OECD/G20 Base Erosion and Profit Shifting Project "Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2015 Final Report" (2015).
[338] As above.
[339] Section 7701(o)(5)(A) of the IRC defines the economic substance doctrine as *"the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose."*
[340] As above.
[341] Section 7701(o)(1)(A) and (B) of the IRC.
[342] Section 7701(o)(1)(A) of the IRC.
[343] Section 7701(o)(1)(B) of the IRC
[344] Kujinga 2015 *SA MERC LJ* 6.

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form principle to dismiss intermediate entities acting as conduits or shams for obtaining DTA benefits.[345]

5. 4 The US Model Tax Treaty

The US Model Treaty, defines treaty shopping non-exhaustively and contains an unequivocal statement that:

> "*tax treaties should include provisions that specifically prevent misuse of treaties by residents of third countries*".[346]

This statement, although broadly worded, aligns with the recommendation of the OECD that treaties should clearly state that the treaty is not intended to create opportunities for non-taxation or reduced taxation through treaty shopping.[347]

5.4.1 LOB Provision

The LOB provision in the US Model Tax Treaty is outlined in Article 22 and is designed to ensure that foreign entities qualify for treaty benefits only if they have a substantial connection to one of the treaty states.[348]

Recognised by the OECD in the BEPS Action 6 final report,[349] the LOB provision has faced criticism for its complexity, leading to OECD's exploration of simplified versions in 2015 and further refinement in 2016.[350] While generally targeted, the LOB may be overly inclusive in granting benefits, allowing discretion in specific circumstances.

The US LOB imposes eligibility criteria for claiming tax benefits, requiring residents of treaty partner states to pass an annual test, ensuring fairness in cross-border taxation.[351] It mandates a genuine presence in the treaty state and objective eligibility tests for each

[345] US IFA Report in para 1.2.1 at 829 which refers to the decision in *Teong-Chan Gaw v Commissioner*, T.C. Memo, 1995-531, 70 T.C.M. 1196.
[346] See Technical Explanation on Article 22 of US Model.
[347] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) para 19.
[348] Art 22 of the 2016 US Model Tax Treaty.
[349] OECD/G20 Base Erosion and Profit Shifting Project "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report" (2015) para 19 and 25.
[350] As above.
[351] Art 22 para 7 of the 2016 US Model Tax Treaty.

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person in the ownership chain.[352] Despite criticisms, the US insists on including the LOB provision in its tax treaties to prevent residents of third states, especially tax havens, from accessing treaty benefits. South Africa's 1997 DTA with the US features an LOB provision in Article 22.[353]

5.5 Lessons from the US for South Africa

The vast disparity in economic scale and the maturity of the US legal system provides South Africa with a unique opportunity to learn from US efforts in combating treaty shopping. While both states employ different strategies, it is essential to understand that there is no one-size-fits-all solution to address these issues. Thus, we must examine the lessons that can be adapted to South Africa's specific context.

In examining lessons from the US for South Africa across various tax-related domains, key insights have emerged. South Africa's hybrid mismatch rules[354] can be fortified by aligning with US counterparts[355] emphasising global standards like OECD BEPS Action 2 recommendations.[356] By adopting the clarity of US regulations and expanding coverage to address diverse hybrid arrangements, potential loopholes can be closed.

BEAT offers South Africa valuable lessons in implementing a minimum corporate tax for large MNEs, ensuring fairness, preventing base erosion, and systematically calculating tax benefits.[357] The transfer pricing domain presents an opportunity for South Africa to learn from the US's comprehensive approach, which includes detailed documentation requirements and formal APAs.[358] South Africa, having recently proposed legislation for an APA program, has an opportunity to draw insights from the well-established US APA framework. Learning from the US, South Africa can enhance its comparability analysis by

[352] Art 22 of the 2016 US Model Tax Treaty.
[353] Published in Government Gazette No. 185553 of 15/12/1997.
[354] Section 23M and 23N of the Income Tax Act.
[355] Sections 267A and 245A of the IRC.
[356] OECD/G20 Base Erosion and Profit Shifting Project "Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report" (2015).
[357] Section 59A of the IRC.
[358] Section 1.482-6 of the Treasury Regulations under the IRC.

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employing specific methodologies like the CUP method for determining arm's length pricing.[359]

South Africa can enhance its thin capitalisation rules by adopting the US ESR rules which use a fixed ratio approach, providing clear numerical thresholds and fixed percentages.[360] This approach is more objective than the current South African debt-to-equity ratio, which may involve intricate calculations and subjective evaluations.[361] ESR can provide South Africa with a more streamlined and straightforward method in assessing interest deductions, fostering compliance and minimising interpretative challenges.

Finally, in understanding tax avoidance, South Africa can benefit from the US economic substance doctrine, which considers a broad range of economic factors, as opposed to that of the South African “substance over form” doctrine, which focuses specifically on the relationship between legal form and economic substance.[362] South Africa can enhance its approach by adopting a comprehensive view that looks beyond legal structures to consider economic realities and business purpose in transactions. Clear legislative guidance, as seen in the US, can improve transparency and reduce uncertainty.

5.6 Conclusion

In their commitment to combating treaty shopping and upholding the integrity of its tax system, the US has implemented a multifaceted strategy combining legislative provisions and anti-abuse doctrines, presenting valuable lessons for states such as South Africa.

Significant components of this strategy include SAARs, with BEAT acting as a pivotal minimum tax to curtail BEPS, particularly targeting large MNEs. The emphasis on transfer pricing rules ensures precision in reflecting income from controlled transactions.[363] Amendments to the IRC, notably Sections 267A and 245A, directly confront hybrid arrangements, aligning with OECD recommendations for global tax fairness and mitigating avenues for tax avoidance, including treaty shopping. GILTI provision focuses

[359] Section 1.482-3 of the Treasury Regulations under the IRC.
[360] Section 163(j)(B) and (C) of the IRC.
[361] Oguttu *International Tax Law: Offshore Tax Avoidance in South Africa* (2015) 213-215.
[362] Legwaila 2016 *SA Merc LJ* 5.
[363] Section 482 of the IRC.

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on intangible income, diminishing incentives for tax avoidance by taxing foreign earnings of US MNEs.[364] ESR, indirectly discourage treaty shopping practices by limiting the deductibility of interest payments.[365] The ongoing fight against treaty shopping underscores the need for continuous adaptation and improvement of strategies to ensure fair and efficient cross-border taxation.

[364] Section 951(A) of the IRC.
[365] Section 163(j) of the IRC.

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Chapter 6: Recommendations and Conclusion

6.1 Introduction

This chapter underscores the global concern of treaty shopping in international taxation, offering targeted recommendations for South Africa. Drawing insights from OECD guidelines, international experiences, and the nation's distinctive economic landscape and legislative framework, these suggestions aim to strengthen South Africa's position against treaty shopping. The chapter then brings the study to an end with an overall conclusion.

6.2 Recommendations

Before implementing any recommendations, South Africa should consider its specific economic and regulatory context.[366] Balancing the need to prevent treaty abuse with the objective of attracting foreign investment and promoting economic growth is vital.[367] South Africa's unique position as a developing nation should guide the implementation of these measures.[368]

6.2.1 Improved clarity of the terms contained in the South African GAAR

Improving the South African GAAR involves addressing several key areas, including legislative changes and enhanced guidance for interpreting and applying the rule. One critical aspect for enhancement is providing greater clarity in the terms contained within the GAAR.[369] Clear and well-defined terms within the GAAR provisions should be established to reduce ambiguity. This includes specifying what constitutes "normal" in terms of the business purpose test.[370] The current ambiguity and uncertainty surrounding the GAAR may serve as a deterrent for some taxpayers, as they may be hesitant to

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[366] Oguttu "A critique on the OECD Campaign against Tax Havens: Has it been successful? A South African perspective" 2010 *Stellenbosch Law Review* 20.
[367] Leduc and Michielse 2021 *IMF* 144.
[368] National Planning Commission "National Development Plan 2030 Executive Summary" https://www.gov.za/sites/default/files/Executive%20Summary-NDP%202030%20-%20Our%20future%20-%20make%20it%20work.pdf (accessed 20 September 2023) 19.
[369] Kujinga 7.
[370] Section 80A (a)(i) of the Income Tax Act.

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engage in transactions that push the boundaries between permissible and impermissible avoidance.[371] While this uncertainty can discourage tax avoidance, it can also lead to inconsistent judicial decisions and standards which can limit the efficacy of the GAAR. To strike a balance, it is essential that South Africa consider a more targeted and precise GAAR.

6.2.2 Consolidation of the purpose requirement and tainted elements

The GAAR in South Africa currently consists of two distinct tests: the "sole or main purpose" requirement[372] and the "tainted elements"[373] requirement. Both of these tests must be satisfied before the GAAR can be applied to a specific tax-avoidance scheme. This dual-test structure has been seen by some as a potential weakness in the GAAR because it provides taxpayers with an opportunity to potentially escape its application by challenging either of these requirements individually.[374] In essence, the taxpayer can argue that their scheme was not solely or mainly for tax avoidance purposes or that it did not contain tainted elements, effectively circumventing the GAAR.[375]

To address this perceived weakness, a potential improvement could involve consolidating these two tests into a single inquiry. In this revised approach, the abnormality or artificiality of the scheme itself could directly inform the purpose behind it. If the scheme is deemed to be abnormal or artificial, it would automatically trigger the application of the GAAR, regardless of whether it was primarily or solely motivated by tax avoidance or contained tainted elements.[376] This would place more emphasis on the substance and economic reality of the transaction rather than focusing on the taxpayer's specific intentions, potentially strengthening the anti-avoidance framework and making it more difficult for taxpayers to evade the GAAR's application.

6.2.3 Implementation of Harsher Penalties in the GAAR

[371] Kujinga 50.
[372] Section 80A of the Income Tax Act.
[373] S80A (c)(ii) of the Income Tax Act.
[374] SARS 2005 Discussion paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 44.
[375] Pidduck 72.
[376] Pidduck 317.

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The South African GAAR has been criticized for its potential ineffectiveness in deterring tax avoidance, primarily due to the absence of punitive penalties when the GAAR is successfully applied.[377] Under the current framework, the Commissioner of SARS is only authorised to impose the tax that would have arisen in the absence of an impermissible avoidance arrangement. This means that taxpayers found in violation of the GAAR are essentially required to pay the same amount of tax as they would have if they had not engaged in the tax avoidance scheme.[378] In effect, this lack of financial penalties or disincentives may encourage some taxpayers to take the risk of implementing such schemes, as they face no additional financial consequences beyond potential interest charges and a possible R1 million penalty for failure to report, as per the reporting rules in the Tax Administration Act.[379]

To address this issue and enhance the deterrent effect of the GAAR, one potential solution could involve the introduction of more severe penalties or financial sanctions for taxpayers found in violation of the rule.[380] Implementing harsher penalties, such as fines or additional tax liabilities, could create a stronger disincentive against engaging in tax avoidance practices. This would not only serve as a financial disincentive but also send a clear message that tax avoidance will not be tolerated, thus strengthening the overall effectiveness of the GAAR in deterring such practices.

6.2.4 Improved Policy on Withholdings Taxes

Withholding taxes serve as a straightforward and effective anti-avoidance mechanism that ensures a consistent source of tax revenue, and they are generally less susceptible to BEPS activities.[381] In South Africa, a state with significant diversity in its economic landscape, substantial disparities exist between its domestic withholding tax rates and

[377] SARS "Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)" (2006) 44 https://www.sars.gov.za/wp-content/uploads/Legal/DiscPapers/LAPD-LPrep-DP-2005-01-Discussion-Paper-Tax-Avoidance-Section-103-of-Income-Tax-Act-1962.pdf (accessed 10 June 2023).
[378] Pidduck 317.
[379] Part B of Chapter 4 of the Tax Administration Act.
[380] SARS "Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)" (2006) 57.
[381] Leduc and Michielse 2021 *IMF* 8.

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those found in its international tax treaties.[382] For instance, the domestic dividend withholding tax rate in South Africa is set at 20%, but it can be reduced to 5% or 15% depending on the holding structure under certain treaties.[383] To address this divergence and promote tax fairness, South Africa should establish a policy that does not offer overly drastic reductions in withholding tax rates in its treaties when compared to its domestic rates. Such a policy would have several benefits, including ensuring tax revenue consistency, preventing treaty shopping, deterring aggressive tax planning, and aligning with global efforts to create a level playing field in international taxation while promoting transparency and simplicity in tax administration and compliance.[384] It is recommended that when re-negotiating the new limits for treaty withholding tax rates, caution is exercised since high withholding taxes can be a disincentive to foreign investment. Equilibrium must be achieved between encouraging foreign investment and protecting South Africa's tax base from erosion.[385]

6.2.5 Strengthening Transfer Pricing Regulations:

It is essential to acknowledge that while South African transfer pricing rules indirectly contribute to regulating treaty shopping, they are not a comprehensive solution. Treaty shopping often involves complex structures, including the use of intermediary jurisdictions and the exploitation of tax treaties. In order to fully address the issue, South Africa should complement these rules with strengthened anti-abuse provisions in its tax treaties and collaborate internationally to create a more comprehensive framework for preventing treaty shopping.

South Africa must continue to enhance its transfer pricing regulations in alignment with the OECD Transfer Pricing Guidelines.[386] By adopting internationally recognized methods such as the comparable uncontrolled price ("CUP") method and implementing rigorous documentation requirements, South Africa can ensure that cross-border transactions are

[382] Leduc and Michielse 2021 *IfMF* 153.
[383] Davis Tax Committee "Summary of report on Action 7: Prevent the artificial avoidance of permanent establishment status" 41.
[384] Davis Tax Committee "Summary of report on Action 7: Prevent the artificial avoidance of permanent establishment status" 43.
[385] As above.
[386] Davis Tax Committee "Summary of DTC report on actions 8 to 10: Aligning transfer pricing outcomes with value creation; and 13 re-examining transfer pricing documentation" 3.

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taxed fairly and consistently.[387] The CUP method involves comparing the price charged in a controlled transaction to the price charged in a similar uncontrolled transaction between unrelated parties. South Africa should encourage the use of the CUP method, where applicable, to ensure that intercompany pricing is in line with market prices.

6.2.6 Implementing ESR:

South Africa should consider adopting ESR based on the OECD's recommendations as a more effective approach to prevent excessive interest deductions and profit shifting compared to the existing thin capitalisation rules.[388] ESR offers a comprehensive solution that covers a wider range of financial transactions, ensuring a fairer taxation of cross-border activities. It provides clear guidelines, limiting interest deductions to a percentage of earnings before interest, taxes, depreciation, and amortization ("EBITDA") or taxable income.[389] Implementing ESR can simplify tax compliance, reduce complexity in tax administration and enhance global alignment.

6.3 Conclusion

This research delves into the significant issue of treaty shopping and its impact on South Africa's tax base, emphasizing the urgent need to address profit-shifting practices in a state with relatively high corporate income tax rates, inadvertently fostering treaty shopping. This practice, driven by factors like preferential tax rates and incentives, poses a substantial risk of treaty abuse and tax evasion. South Africa's response to this challenge is comprehensive, employing tools such as the GAAR, various SAARs, and common law doctrines within its domestic legislation. Actively participating in the OECD BEPS project underscores South Africa's commitment to combatting international tax issues and preventing tax avoidance.

The pivotal adoption of the OECD MLI in 2017 and its subsequent ratification in 2022 showcase South Africa's dedication to aligning its tax treaties with global standards,

[387] Davis Tax Committee "Summary of DTC report on actions 8 to 10: Aligning transfer pricing outcomes with value creation; and 13 re-examining transfer pricing documentation" 10.
[388] Davis Tax Committee "Summary of DTC report on action 4: Limit base erosion via interest deductions and other financial payments" 12.
[389] As above.

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effectively countering treaty shopping and other forms of tax avoidance. This streamlined approach to implementing tax treaty-related measures not only equips South Africa with a powerful tool to address BEPS concerns in existing bilateral tax treaties but also simplifies the process of ensuring consistency and transparency in international tax matters.

South Africa's proactive engagement with international tax regulations and its unwavering commitment to tackling treaty shopping have positioned the nation as a significant player in the global effort to create a fair and effective international tax system. Notably, the recent introduction of the APA program reflects South Africa's ongoing efforts to strengthen its stance against treaty abuse.

As recommended in Chapter 6, South Africa has the opportunity to further enhance its approach by considering key recommendations, paving the way for a more robust and effective regulatory framework that safeguards its tax base and promotes transparency in the international tax landscape. The proposed measures include developing a comprehensive policy for treaty negotiation, emphasizing collaboration with African nations to ensure accurate interpretation and prevent double taxation. Enhancements to the GAAR involve providing greater clarity in its terms to discourage ambiguity and promote consistent judicial decisions. The consolidation of dual tests within the GAAR, along with the introduction of harsher penalties for violators, aims to fortify its effectiveness against tax avoidance. Additionally, an improved policy on withholding taxes seeks to align domestic and international rates, fostering tax revenue consistency and deterring treaty shopping. Strengthening transfer pricing regulations and considering ESR based on OECD recommendations further contribute to a comprehensive strategy for fair and efficient cross-border taxation. Collectively, these recommendations offer a coherent framework tailored to South Africa's specific needs in combating treaty shopping and aligning with global standards.

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