

**THE INTERPRETATION OF SOUTH AFRICAN DOUBLE TAXATION  
AGREEMENTS UNDER INTERNATIONAL LAW**

**BY**

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## DECLARATION

I, Benhardt Laurentius Johannes, 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 it's entirely 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 in accordance with the University of Pretoria requirements. I am aware of the University of Pretoria policy and implications regarding plagiarism

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Date: \_\_\_\_\_

## DEDICATION

I dedicated this dissertation to the most important person in my life, my late mother Magdalena Kunas Johannes who passed away while I was busy with this project. I would like to thank her for being a constant source of strength. You gave me roots, eternal hope and wings. You have trained me that hard work brings success. I regret that you died before I was fully able to spread my wings. Thank you. Mother, RIP.

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## LIST OF ABBREVIATIONS

COT	Commissioner of Taxes
CIR	Commissioner of Inland Revenue
DTA	Double Tax Agreement
FMC	Ford Motor Corporation
FMCL	Ford Motor Company Limited
HMRC	The Commissioners for her Majesty's Revenue and Customs
ICJ	International Court of Justice
ITC	Income Tax Court (Special Court)
OECD	Organisation for Economic Co-operation and Development
OECD MTC	Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital
NA	National Assembly
NRST	Non-resident shareholders tax
POEM	Place of Effective Management
SATC	South African Tax Cases
SARS	South African Commissioner for Revenue Services
SIR	Secretary for Inland Revenue
VCLT	Vienna Convention on the Law of Treaties

## ABSTRACT

This dissertation interrogates which principles should govern the interpretation of South African Double Tax Agreements ('DTAs'). This field of study is complex because any DTAs have a dual nature. In the first place, it is an international agreement where two states are parties (a bilateral agreement); second, it also becomes part of domestic law. DTAs are governed by principles of customary international law some of which have been codified in the Vienna Convention on the Law of Treaties ('VCLT'). Though South Africa is not a party to the VCLT, nevertheless, there is judicial support in South Africa for the notion that VCLT reflects general principles of international law [*Harksen v President of the Republic of South Africa* 1998 (2) SA 1011 (C)]. DTAs are incorporated into South African domestic law by way of statutory enactment in accordance with the dualist approach to international law.

The first purpose of the dissertation is to systematise and analyse the structure of an OECD Model Tax Convention ('OECD MTC') and the international methods (principles) of interpretation of DTAs in order to gain a better understanding of how this international methods functions. A number of issues relating to the interpretation of these methods are analysed. Since DTAs are applied by tax authorities, courts and taxpayers in a domestic law context, i.e. within the framework of the legal system of a particular state, the analysis focuses on the application in South Africa of the methods of the interpretation of South African DTAs.

The second objective of the dissertation refers to international tax law principles (treaties and customary international law) derived from South Africa public international law and to evaluate a few selected issues related to South African DTAs and their relevance to South Africa domestic tax laws; the interpretation of DTAs and the implications of a DTA overriding or in conflict with South Africa domestic tax laws. It will also interrogate the legal status of a DTA under South African tax law and whether the anti-discrimination article in South Africa DTAs have the force of law in South Africa?

**Keywords:** Assignment rules, Bilateral Agreement, Context, Common Interpretation, Customary International Law, Doctrine of self-executing treaties, Double Taxation, Double Tax Agreements, Exemption with progression, full credit, Model Tax Convention on Income and on Capital, International agreement, Interpretation of Double Tax Agreements, International Law, Irreconcilable conflicting issues, Ordinary Tax Credit Method, Parallel Treaties, Tax Sparing Credit, Static versus Ambulatory interpretation, Taxation of Income,

The OECD Model, The UN Model, The Commentaries of the OECD Model, Vienna Convention on the Law of Treaties.

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# 1 CHAPTER 1: INTRODUCTION

## 1.1 Background to the Study

The rise and growth of multinational corporations have modified the legal and economic relations amongst States. Expanded foreign direct investment and the concomitant opening up of new economies to foreign investors have made international legal and fiscal arrangements between States more complex.<sup>1</sup> One of the immediate outcomes has been the improved coordination in taxation among States.<sup>2</sup> Apart from the unilateral measures, the principal purpose of Double Taxation Agreements ('DTAs') is to mitigate this potential for double taxation and thereby remove an important potential hindrance to global trade.<sup>3</sup>

A secondary purpose of DTA is to facilitate information sharing between countries' tax authorities, thereby strengthening the enforcement of each country's tax laws and preventing tax evasion.<sup>4</sup> This two-fold purpose of DTA is highlighted by the official titles of many DTAs.<sup>5</sup> DTAs are sometimes referred to as double tax treaties or conventions.

A DTA is a kind of contract and it is defined as '... an international treaty concluded between two States to determine the incidence of tax in, and the application of tax laws by, each state during the same period with the object of avoiding double taxation'.<sup>6</sup> Thus, DTAs are international bilateral agreements between two States.<sup>7</sup> These agreements are not negotiated from scratch, but instead tend to be based on various model treaties, most often the model treaty developed by the Organisation for Economic Co-operation and Development

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<sup>1</sup>Kransdorff, M. (2010). Tax Incentives and Foreign Direct Investments in South Africa, p 71; See also Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 2.

<sup>2</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 25.

<sup>3</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 6.

<sup>4</sup>See the case of *Ben Nevis (Holdings) Limited & Metlika Trading Limited v The Commissioners for HMRC (Her Majesty's Revenue and Customs)* [2013] EWCA Civ 578, where the Court of Appeal of England and Wales considered the interpretation of the mutual assistance provisions in the DTA between the United Kingdom ('UK') and Republic of South Africa ('RSA').

<sup>5</sup>For example 'Convention between the Republic of South Africa and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income'.

<sup>6</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 841.

<sup>7</sup>*Ibid* p 271.

(‘OECD’).<sup>8</sup> The OECD Model Tax Convention (‘OECD MTC’) is dynamic in that it is continuously scrutinized and modernised as economies change and new double taxation issues arise.

The parties to a DTA are referred to as ‘contracting States’.<sup>9</sup> A DTA is subject to the general law on treaties as codified in the Vienna Convention on the Law of Treaties (‘VCLT’), as with other treaties.<sup>10</sup> DTAs usually relate to the income and capital tax, although there are some DTAs applicable to other taxes, such as gift, estate and inheritance duties, social security taxes, and superannuation (including tax).<sup>11</sup> There are a number of model tax agreements published by various national and international bodies.<sup>12</sup> The two most widely known are the Andean Pact<sup>13</sup> and the Nordic Convention.<sup>14</sup> Both these agreements are regionally based reflecting unities in the design of the income tax among the contracting States.

The main purposes of a DTA is usually set out in the preamble to the DTA, which commonly states that the purposes of the DTA are the avoidance of double taxation and the prevention of fiscal evasion.<sup>15</sup> While usually not stated in the preamble, a third purpose of DTAs is non-discrimination. There are a number of ways in which double taxation can arise. Where a

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<sup>8</sup>See the Model Tax Convention on Income and on Capital (2010). Condensed Version, Paris. This volume contains the treaty text, specific commentaries on each treaty article, and an introduction that provides further interpretive guidance.

<sup>9</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 3.

<sup>10</sup>*Ibid* p 2; See also Vogel, K. (1997) Double Taxation Conventions Kluwer Law International, p156, marginal note 52.

<sup>11</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 3.

<sup>12</sup>*Ibid* p 290.

<sup>13</sup>Vogel, K. (1997) Double Taxation Conventions Kluwer Law International, p 18, marginal note 68. The Contracting States are Bolivia, Colombia, Chile, Ecuador, Peru and Venezuela.

<sup>14</sup>The Contracting States are Denmark, Faroe Islands, Finland, Iceland, Norway and Sweden.

<sup>15</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 276. See also Convention Between The Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income and on Capital Gains <http://www.sars.gov.za/home.asp?pid=3919> (Assessed on 13 April 2013).

taxpayer is resident in one State but has a source of income or capital situated in another State, it gives rise to juridical double taxation.

This arises from two basic principles that enable the residence State as well as the source State to impose tax, namely, ‘source jurisdiction’<sup>16</sup> and the ‘residence jurisdiction’<sup>17</sup> where there is a connexion between the State wanting to tax and person subject to tax. The source rule stipulates that income is to be taxed in the State in which it originates irrespective of whether the income accrues to a resident or a non-resident<sup>18</sup> whereas the residence rule holds that the authority to tax should rest with the State in which the taxpayer residence is.<sup>19</sup> If both rules apply simultaneously, a taxpayer will suffer tax at both ends.<sup>20</sup> It is from this point of view that DTA becomes very significant.

The purpose of DTA can be viewed from two perspectives, the governments and the taxpayer’s.<sup>21</sup> The states aim for improved cooperation amongst themselves for combating fiscal evasion. DTAs are used to relieve residence-source double taxation allocation of taxing rights between residence and source countries and give priority to source taxation where competing rights also solve residence-residence double taxation through tie-breaker rules by addressing some types of source-source double taxation (but not triangular cases). The aim of DTAs is to eliminate the burden of juridical double taxation.<sup>22</sup>

A taxpayer’s view of a DTA is different, and they are not likely to be impressed with the provisions against fiscal evasion. The provisions for exchange of information are also likely to intimidate taxpayer’s.<sup>23</sup> The information now provided by them to their resident states may

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<sup>16</sup>Brian, A. & McIntyre, M. (2002). International Tax Primer, p 21.

<sup>17</sup>*Ibid* p 15.

<sup>18</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p11.

<sup>19</sup>*Ibid* p 19.

<sup>20</sup>*Ibid* p 10.

<sup>21</sup>*Ibid* p 276.

<sup>22</sup>*Ibid* p 276 -276; See also Brian, A. & McIntyre, M. (2002). International Tax Primer, p 105 – 106.

<sup>23</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 276; See generally CSARS v Van Kets 2012(2) All SA 420 (WCC)h - j where Davis J held that the interpretation of South African Revenue Services information-gathering powers in terms of s 74A and s 74B of the Income Tax Act must take account of South Africa’s obligations under DTAs.

easily be available from the authorities of another state with which DTAs have been negotiated.<sup>24</sup> It is observed that this might even incite a taxpayer to adopt various undesirable practices, such as the withholding of important information, to serve their own purposes.

South Africa has approximately 70 DTAs in place,<sup>25</sup> the first of which was entered into with Zambia.<sup>26</sup> These are generally based on the Organisation for Economic Co-operation and Development's ('OECD') *Model Tax Convention on Income and on Capital* ('the OECD MTC').<sup>27</sup> South African DTAs also include some features of United Nations' Tax Convention. The number has been increasing steadily in recent years. The number of DTAs indicates that South Africa has strong trade ties with a large number of states.

South Africa is not a member of the OECD, but achieved so-called observer status in 2004, and therefore uses the OECD MTC in negotiating its DTAs.<sup>28</sup> The OECD MTC, with or without the UN modifications, is considered to be an ideal basis for the negotiation of South African DTAs.<sup>29</sup> A major benefit in adhering as closely as possible to the OECD MTC is the ready availability of the international experience in the interpretation of DTAs.

There exists a debate regarding the conceptual justification that South African DTA, like any treaty should be interpreted according to the principles of public international law pertaining to treaties. These principles have now been codified in the Vienna Convention on the Law of Treaties ('VCLT'),<sup>30</sup> although South Africa is not a signatory to the VCLT. It is noteworthy that this area has received little attention in South Africa, unlike European States where it has prompted lively debate.

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<sup>24</sup>Brian, A. & McIntyre, M. (2002). *International Tax Primer*, p 106.

<sup>25</sup>Olivier, L. & Honiball, M. (2011). *International Tax: A South African Perspective*, p 291.

<sup>26</sup>*Ibid* p 25.

<sup>27</sup>Organisation for Economic Co-operation and Development *Model Tax Convention on Income and on Capital*.(2010).Condensed Version, Paris.

<sup>28</sup>Olivier, L. & Honiball, M. (2011). *International Tax: A South African Perspective*, p 270.

<sup>29</sup>*Ibid* p 8.

<sup>30</sup>Signed at Vienna on 23 May 1969.

## 1.2 Problem statement

The main problem that this dissertation aims to address is how South African DTAs can be interpreted under international law. Specifically, it seeks to interrogate whether South African courts are constitutionally bound to follow the rules of interpretation of treaties as contained in the VCLT and give preference to an interpretation that is consistent with public international law, or apply the South African ordinary rules of statutory interpretation. South African courts accept that they must sometimes apply principles of international law<sup>31</sup> and that the interpretation of international agreement (like DTA) is a branch of international law.<sup>32</sup>

As mentioned earlier, South Africa follows the direct effect approach when DTAs are brought into effect.<sup>33</sup> Thus, strictly speaking, when a South African court interprets a DTA, it is interpreting legislation and ordinary rules of statutory interpretation should apply. But the question is whether DTAs can be interpreted by the courts applying the ordinary rules of statutory interpretation or the rules applicable in interpretation of treaties accepted under customary international law?

## 1.3 Research questions

The main research question that this study will seek to answer is: are the rules of customary international law, referred to as common law of public international law, as codified by the VCLT, binding on South Africa DTA even if South Africa is not a signatory to the VCLT?

In answering the main question, the following questions will also be answered to elucidate the central thesis of this study:

- ✓ what are the global approaches of DTA interpretation?
- ✓ what are the sources that South African courts must consult when interpreting international treaties?
- ✓ how do South African courts interpret South African DTAs?

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<sup>31</sup>Section 232 of the Constitution of the Republic of South Africa, 1996. section 232 is not a complete statement on the subject of customary international law in South Africa. It is still necessary to turn to judicial precedents to decide which rules of customary international law are to be applied and how they are to be proved.

<sup>32</sup>Pan American World Airways v SA Fire and Accident Insurance Co Ltd 1965 (3) SA 150 (A) p 161C-D.

<sup>33</sup>Section 108 (2) of Act 58 of 1962.



#### 1.4 Thesis statement

The thesis statement of this investigation is that the correct approach to the interpretation of South African DTAs is the self-styled international interpretation which is consistent with the OECD approach. Interpretation of DTAs should be governed by the provisions of VCLT as it codifies the applicable principles under customary international law on the interpretation of treaties, regardless of the fact that South Africa is not a signatory to the VCLT.

#### 1.5 Literature review

A dramatic increase in foreign direct investment into South Africa after the 1994 led to South Africa signing DTAs with many States. There is relatively few literature on the interpretation of South African DTAs under international law and the evidence that can be gleaned from international studies is conflicting. In this section, only the literature that deals with methods of interpretation and their effects on DTAs are reviewed.

The literature under review can be divided into two: those who are of the view that DTAs should be interpreted under statutory domestic law and those who argue that the rules of international law should prevail. DTAs present more than the usual set of problems that attend the interpretation of a text with legal significance. This is because of the very special purposes, process of formulation, and legal nature of DTAs.<sup>34</sup>

In one of the earliest studies, Vogel and Prokisch, [in an introduction to the General Report for the International Fiscal Association on the interpretation of DTA] state as follows about interpretation of treaties:

“An interpretation can only be ‘correct’ if it has not come about by arbitrary procedure. Therefore, criteria for interpretation are needed to guide the interpreter and let him and others control the interpreting procedure. These criteria are defined in a more or less similar way all over the world.”<sup>35</sup>

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<sup>34</sup>Double tax treaties (or tax conventions) have greatly proliferated in recent years. South Africa has double tax treaties currently in force with 72 countries, and several other DTAs have been signed but await ratification. There are more than 200 DTAs in force between OECD member and non- member countries alone.

<sup>35</sup>Klaus & Prokisch, R.G. (1993). ‘General Report,’ in International Fiscal Association, *Cahiers de droit fiscal international*, Vol. 78a. Interpretation of Double Taxation Conventions, p 56.

In this regard, Vogel highlights the fact that the interpretation of international agreements is a process regulated by law, and 'like domestic tax law, requires interpretation'.<sup>36</sup> Various writers, including Vogel, point out that the VCLT forms the basis for interpretation of DTAs. They posit that the provisions of the VCLT are even referred to by courts of states which have not yet ratified the VCLT.<sup>37</sup> Baker argues that VCLT contains the rules of interpretation of treaties and is regarded as declaratory of customary international law.<sup>38</sup>

Similarly, Edwards-Ker argues that courts generally apply the VCLT as 'part of law of the land'.<sup>39</sup> He notes in this respect that a uniform domestic approach cannot be identical to any one particular state's approach to the interpretation of its purely domestic tax statutes because such approaches do not take sufficient account of the fact that a DTA is a treaty which must be interpreted in accordance with the common understanding of both contracting States.<sup>40</sup> Edwards-Ker also notes that, 'in many states, courts can consider a DTAs' domestic legislative history - which may be persuasive at a domestic level but not necessarily at a public international level', and gives some examples of state practice.<sup>41</sup>

In *Thiel v. FC of T*,<sup>42</sup> the Australian High Court endorsed a reference to broader international law principles when interpreting DTAs. McHugh J's judgment (with which the majority agreed in their joint judgment) outlines the applicable international law principles in interpreting DTAs. The judge's comments confirm that it is necessary as a matter of practice to apply international law principles when interpreting a DTA as incorporated in the Australian taxation law.<sup>43</sup>

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<sup>36</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 33, marginal note 58.

<sup>37</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 35, marginal note 68.

<sup>38</sup>Philip, B. (1994). Double Taxation Conventions and International Tax Law, p 22.

<sup>39</sup>Edwardes-Ker, M. (1995). Tax Treaty Interpretation, Chapter 3.01.

<sup>40</sup>*Ibid* para 1.05 and chapter 5.

<sup>41</sup>*Ibid* para 25.02.

<sup>42</sup>90 ATC 4717.

<sup>43</sup>*Ibid* p 4727; See also the similar comments of Dawson J, p 4722.

Vogel<sup>44</sup> holds that a common interpretation should be sought which is accepted by both contracting states. Common interpretation, Vogel explains, can only be achieved if the DTA is applied consistently by the competent authorities and courts of the contracting States. The concept of common interpretation is also embodied in Article 33 (4) of the VCLT regarding the interpretation of treaties negotiated in multiple languages. Common interpretation is also a rule of interpretation in domestic law; a judge is expected to examine the decisions of other courts and evaluate their reasoning.<sup>45</sup> Vogel also states that parallel DTAs of a given state may also provide some assistance in the interpretation of other DTAs of that state.<sup>46</sup>

Avery Jones *et al.*<sup>47</sup> argues that the OECD Model and its Commentaries are very important for the interpretation of DTAs in that they provide a source from which courts of different states can seek a common interpretation. He eloquently submits that:

“a point to be made at the outset is that treaty interpretation is a subject in itself and not merely an extension of statutory interpretation, as has sometimes been thought in common law countries where treaties normally take their effect by virtue of a statute.”<sup>48</sup>

The learned authors, Olivier and Honiball, are of the view that DTAs provisions have become part of the South African domestic law.<sup>49</sup> Therefore, the provisions of the DTAs and the Income Tax Act should be reunited and read as one coherent whole if possible. The approach on this point is in accord with the approach taken by OECD member countries, treaty cases, and represents international interpretation of treaty practice.

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<sup>44</sup>Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 39 – 43., marginal notes 74, 74a, 74b, 75, 75a, 76, 77.

<sup>45</sup>Vogel K. (1986). *Double Tax Treaties and Their Interpretation*, 4 *Berkeley Journal of International Tax & Business Law*, p 37.

<sup>46</sup>*Ibid.*

<sup>47</sup>Avery Jones, J.F., Berg, C.J., Depret, H.R., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A. (1984). *British Tax Review*. The Interpretation of Tax Treaties with Particular Reference to Article 3 (2) of the OECD Model, No. 2, p 90 - 100.

<sup>48</sup>Avery Jones, J.F., Berg, C.J., Depret, H.R., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A. (1984). *British Tax Review*. No. 1. The Interpretation of Tax Treaties with Particular Reference to Article 3 (2) of the OECD Model, No. 1, p 14.

<sup>49</sup>Olivier, L. & Honiball, M. (2011). *International Tax: A South African Perspective*, p 350.

In the main, the point of departure of this study from the literature discussed above is that there is a need to explore the prospects of South African courts' interpretation of DTAs according to rules of customary international law, as codified by VCLT. These may differ from domestic rules and principles which sometimes consist of highly complex and technical language. Treaties, on the other hand, follow a rather general and purposive approach. This study will address some of those gaps that still exist.

## **1.6 Significance of the study**

Many authors have written on the subject of interpretation of DTAs under the VCLT. However, very few literatures published in book form or article form that deals with the interpretation of South African DTAs under customary international law. To date, very few studies have been done where the interpretation of South African DTAs has been internationally compared with a specific focus on customary international law, as codified in the VCLT in the way this research proposes to do. Thus, there is a knowledge gap to compare the South African view with international trends. The most prominent exception is *International Tax: South African Perspective*, authored by Professor Lynette Olivier and Mr Michael Honiball and *Silke on International Tax* constructs by Emil Brincker and Alwyn De Koker, eds.

There is little South African jurisprudence on the subject, and the growing number of new South African DTAs makes it foreseeable that issues of interpretation will soon reach South African courts. The study is likely to provide the impetus for further research into South Africa DTAs interpretation. This study will also add academic value as well informs tax advisors and policy-makers with respect to factors that ought to be taken account in interpretation of South African DTAs.

## **1.7 Research objectives**

The purposes of the study are:

- i. To explore the interpretation of South Africa DTAs under customary international law as codified by the Vienna Convention of the law of Treaties;
- ii. Discuss the interpretation of DTAs using international tax case law as well as international tax scholarly writings in applying the international precedents for interpretation of double tax treaties under the Vienna Convention on the Law of Treaties;

- iii. To examine the legal status of South African DTA, how DTAs are enacted into law in South Africa through national legislation and the irreconcilable conflicting provisions between South African DTAs and of the South African Income Tax Act;<sup>50</sup>
- iv. To discuss common law rules where there are conflicts between South African Income Tax Act and DTAs and whether the anti-discrimination article in South Africa DTAs have the force of law in South Africa law.

## **1.8 Research methodology for the study**

This investigation will essentially be desk-top based and the approaches will be descriptive, prescriptive and analytical. It will also draw on all available online resources, South African income tax legislation, South African income tax cases, international tax cases, opinions expressed in tax journals written by South African and international tax academics, and textbooks to analyse the interpretation of South African DTAs under international law.

This dissertation does not limit itself to South African tax literature; numerous examples are taken from, and references made to, cases in the US, Canada, UK, Australian and other developed economies since the fundamental issues about tax treaty interpretation are essentially the same everywhere.

Since the central objective of this dissertation is to develop interpretations that are internationally applicable, this study therefore proposes an interpretation that favours international harmonisation in tax law.

## **1.9 Limitations of the study**

The study focuses on the interpretation of South Africa DTAs under international law. Other interpretations, such as South African statutory interpretation or interpretation of non-tax treaties, are specifically excluded from this study.

Although a reference to article 3 (2) of the OECD Model is made where relevant, it shall not be critically assessed. Reference to it will be done in order to provide a more complete view of interpretation of DTAs as a whole.

It should furthermore be noted that that this study is limited to the OECD MTC and not the UN or US Model Tax Convention on Income and on Capital. This is based on the fact that

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<sup>50</sup>Act No. 58 of 1962.

the OECD Model is the most commonly used model by South African policy makers when negotiating DTAs.

Due to limitations of time, length and availability of the research materials, only a selection of South African tax and international tax case law and journal articles will be considered. Hence, the cases and journal articles referred to in the study should not be regarded as an exhaustive outline, but are merely representative to discern the different approaches adopted by the parties involved.

### **1.10 Assumptions underlying the study**

Although there is more than one type of treaty used around the world for the interpretation of treaties, the assumption here will be that there is only one type used for the interpretation of DTAs for the purpose of this study, i.e. the VCLT. There will therefore be no analysis on the interpretation of South Africa DTAs under any other form of treaties around the world.

### **1.11 Structure of the study**

Chapter 1, Introduction, is an introductory chapter which covers the background to the study, research problem and questions, research methodology, literature review, significance of research and overview of chapters.

Chapter 2, Structure of a DTA, examines the structure of an OECD MTC DTA. Attempt will be made to analyse the schedular structure of DTA distributive rules and ordering rules applicable to the structure.

Chapter 3, General principles governing the interpretation of DTAs under international law, will interrogate the interpretation of DTAs as international agreements under international law. This shall include the general approach to interpretation, including the one under the VCLT; the impact of Article 3(2) of the OECD MTC; and some other issues relating to common interpretations, parallel treaties, OECD MTC and their Commentaries.

Chapter 4, the South African approach to treaty interpretation, investigates the interpretation of treaties under the South African jurisprudence. It shall also discuss the sources of public international law that South African courts can consult when interpreting an international treaty (common and statutory law).<sup>51</sup>

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<sup>51</sup>Botha, N.J. (2002). The law of South Africa. Volume. 12, para 436 – 463.

Chapter 5, selected issues related to South African DTAs, examines selected issues in relation to South African DTAs and their relevance to domestic tax laws; the interpretation of DTAs and the implications of a DTA overriding or in conflict with domestic tax laws. It will also interrogate the legal status of a DTA under South African tax law and whether the anti-discrimination article in South Africa DTAs have the force of law in South Africa?

Chapter 6, Conclusion, concludes by drawing curtain on this study.

## **2 CHAPTER 2: THE STRUCTURE OF DOUBLE TAX AGREEMENTS AND THEIR APPLICATION IN PRACTICE**

### **2.1 Introduction**

This chapter will examine the typical structure of OECD MTC DTAs. This chapter will not discuss the procedural aspects of an OECD MTC DTA. An OECD MTC DTA can be described as a list of articles, which perform separate and distinctive functions. The articles fall under broad categories, namely those that deal with the application of the DTA; those that set out the distributive rules to avoid juridical double taxation; those that are concerned with the prevention of tax avoidance and fiscal evasion and those that address miscellaneous matters. As the international DTA network is largely based on the OECD MTC, the OECD MTC texts are the focal point of analysis in this chapter.

### **2.2 General structure of an OECD MTC DTA**

The OECD is the leading forum where common positions are developed on cross-border tax policy and administration issues in order to improve certainty for taxpayers and tax authorities.<sup>52</sup> While each DTA will necessarily be unique, as international tax law is a vibrant phenomenon of interaction between States, the common concepts expressed in the OECD MTC as well as the Commentaries serve as a sound basis in the process of DTA negotiation. They will thus play a major role in the interpretation of DTAs that adopt the OECD MTC texts.<sup>53</sup>

Contracting States concluded bilateral DTA in which they allocated taxing rights amongst themselves in order to eliminate double taxation. These DTAs are usually based on the OECD MTC, which gives general rules for the allocation of taxing rights to the various types of income. A major benefit of using the OECD MTC is the presence of the stable and well-respected Commentaries.<sup>54</sup> This provides a valuable tool for interpretation which has widespread international acceptance amongst contracting States which are not even OECD members.<sup>55</sup> The OECD MTC is divided into broad chapters, and then each chapter is

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<sup>52</sup>OECD MTC. (2010). Condensed Version, Paris: Introduction, p1:3.

<sup>53</sup>*Ibid.*

<sup>54</sup>OECD MTC. (2010). Condensed Version, Paris: Introduction, p 14: 28 - 30.

<sup>55</sup>*Ibid* Introduction, p 14: 29.1 - 29.3.



subdivided into a number of standard clauses or articles which contain specific rules.<sup>56</sup> Consistent with source taxation generally, OECD MTC DTAs are schedular in nature. The OECD MTC DTA divides income into a number of categories with taxing rules specified for each category.

The OECD MTC is allocated into seven chapters,<sup>57</sup> but for purposes of this evaluation, the Articles of a DTA can be divided into six groups:

- **Scope Articles:** They are Article 1 (Personal scope), Article 2 (Taxes covered), Article 30 (Entry into force) and Article 31(Termination). These articles determine the persons, taxes and time period covered by the DTA.<sup>58</sup>
- **Definition Articles:** They include Article 3 (General definitions), Article 4 (Residence) and Article 5 (Permanent Establishment). Various terms commonly used in DTAs are defined in these Articles.<sup>59</sup> Certain definitions are also provided in substantive articles e.g. Article 6 (2) defines immovable property; Article 10 (3) define dividends; Article 11 (3) defines interest and article 12 (2) defines royalties.<sup>60</sup> If a term is not defined in the DTA, it would normally assume the meaning that it has under the domestic tax laws of the contracting States.
- **Substantive Articles:** They are Articles 6 to 22 which apply to particular categories of income or capital and allocate taxing jurisdiction between the contracting States.<sup>61</sup> Article 9 is excluded as it is viewed as an anti-avoidance article.
- **Articles for the elimination of double taxation:** Primarily this is Article 23. The mutual agreement article (Article 25) could also be placed in this category.<sup>62</sup>

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<sup>56</sup>*Ibid* Introduction, p 10:17.

<sup>57</sup>Olivier, L. & Honiball, M. (2011). *International Tax: A South African Perspective*, p 271; OECD MTC. (2010). *Condensed Version*, Paris: Introduction p 10:17.

<sup>58</sup>OECD MTC. (2010).*Condensed Version*, Paris: Introduction, p 11:18; See also Baker, P. (1994).*Double Taxation Conventions and International Tax Law*, p 15: B -18.

<sup>59</sup>*Ibid* Introduction, p 11:18; Baker, p 15: B -18.

<sup>60</sup>*Ibid* Introduction, p 11:18; Baker, p 15: B -18.

<sup>61</sup>*Ibid* Introduction, p 11:19; Baker, p 15: B -18.

<sup>62</sup>*Ibid* Introduction, p 13:26; Baker, p15: B -18.

- Anti-avoidance Articles: They are Article 9 (Associated Enterprises) and Article 26 (Exchange of information).<sup>63</sup>
- Miscellaneous Articles: They include Article 24 (Non-discrimination), Article 28 (Diplomats) and Article 29 (Territorial Extension).<sup>64</sup>

### **2.3 The Scope, Taxes Covered, General Definitions and Application of the OECD Model Convention**

Chapters I and II of the OECD MTC headed as scope of the Convention and definitions regulate the requirements for application of the DTA and determine the important definitions of the DTA.<sup>65</sup> Chapter I of the OECD MTC defines both in personal and neutral respect the applicability of the OECD MTC. The purpose of the first article of the OECD MTC is to restrict DTA application to income recipients who are residents of one or both of the contracting States.<sup>66</sup> This single sentence in Article 1 of the OECD MTC is easily misunderstood. It does not say that the DTA only covers income that is received by a resident of one State from a resident of the other State. In order to trigger Article 1 of the OECD MTC one has to look at the general definitions in article 3 (1) (a) and Article 4 of the OECD MTC.<sup>67</sup> Article 3 contains the definitions of the terms ‘person’,<sup>68</sup> ‘company’,<sup>69</sup> ‘enterprises’,<sup>70</sup> ‘enterprises of a Contracting state’,<sup>71</sup> ‘international traffic’,<sup>72</sup> ‘competent authorities’,<sup>73</sup> ‘national’,<sup>74</sup> and ‘business’.<sup>75</sup> These general definitions are given for the

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<sup>63</sup>*Ibid* Introduction, p 13:26; Baker, p 15: B -18.

<sup>64</sup>*Ibid*.

<sup>65</sup>*Ibid* Introduction, p 11:18.

<sup>66</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 1, p 45:1.

<sup>67</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 87, marginal note 13.

<sup>68</sup>OECD MTC. (2010). Condensed Version, Paris: Article 3 paragraph (1) (a).

<sup>69</sup>*Ibid* Article 3 paragraph (1) (b).

<sup>70</sup>*Ibid* Article 3 paragraph (1) (c).

<sup>71</sup>*Ibid* Article 3 paragraph (1) (d).

<sup>72</sup>*Ibid* Article 3 paragraph (1) (e).

<sup>73</sup>*Ibid* Article 3 paragraph (1) (f) (i) (ii).

<sup>74</sup>*Ibid* Article 3 paragraph (1) (g) (i) (ii).

purposes of the DTA and are to apply unless the context otherwise requires.<sup>76</sup> The term ‘person’ is defined to include an individual or a company as well as any other body of persons.<sup>77</sup>

The term “resident” as used in the OECD MTC has various purposes, and it thus plays a crucial role in the application of a DTA. Primarily, the term is necessary to determine the scope of the DTA.<sup>78</sup> A person is only eligible to DTA benefits if it is a resident in one or both of the contracting States. Clarity of the concept of “resident of a Contracting State” is therefore of utmost importance in determining the personal scope of the DTA, determining the legal consequence of primary or secondary taxation,<sup>79</sup> which in turn will pave the way for the application of the distributive rules and methods for the elimination of double taxation found in the DTA.

The general rule in Article 4 of the OECD MTC clarifies who is deemed to be resident and provides that:

“for the purpose of the Convention, the term ‘resident of a Contracting State’ means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature ...”<sup>80</sup>

Article 4(1) OECD MTC does not provide an independent definition of resident. The term resident is simply determined by the definition laid down in the internal law of the contracting States concerned. The term “resident of a Contracting State” simply means any person who, under the domestic law of that contracting State, is liable to tax therein by reason of his domicile...<sup>81</sup> The words “liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature” therefore reflects taxation in

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<sup>75</sup>*Ibid* Article 3 paragraph (1) (h).

<sup>76</sup>*Ibid* Article 3 paragraph (1).

<sup>77</sup>*Ibid* Article 3 paragraph (1) (a).

<sup>78</sup>*Ibid* Article (1).

<sup>79</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 4, p 83:1-2.

<sup>80</sup>OECD MTC. (2010). Condensed Version, Paris: Article 4 paragraph (1).

<sup>81</sup>*Ibid* Commentary on Article 4 (1), p 85:8:6.

connection to the person rather than the income.<sup>82</sup> This is because of the fact that one can argue that the use of the words “by reason of” imposes a causal link between the “liability to tax” and one of the abovementioned connecting factors.<sup>83</sup>

If a person is by virtue of the internal laws of both of the contracting States a resident in both States. In such a case Article 4 (2) of the OECD MTC for individuals, as well as Article 4 (3) of the OECD MTC for persons other than individuals act as a tie breaker rule.<sup>84</sup> This means that the term residence for the purpose of the DTA is determined in one of the contracting States. In the case of individuals (in the order stated) the ‘permanent home’<sup>85</sup> ‘centre of vital interests’<sup>86</sup>, ‘habitual abode’<sup>87</sup> are decisive. The contracting States will have to settle this question by mutual agreement if the residence issue is not settled by the above stated criteria.<sup>88</sup> Whereas the various abovementioned steps solve individual’s dual residents the place of ‘effective management’ is decisive where a company or other bodies of persons are deemed resident of both of the contracting States.<sup>89</sup> Therefore, DTA residence is assigned to the contracting State where the ‘place of effective management’ is located.

After the personal scope application is determined, the focus turns to the taxes covered article in a DTA.<sup>90</sup> Article 2 provides for a system whereby the taxes covered under the DTA are determined.

## 2.4 Specified Taxes Covered by the DTA

Article 2(1) of the OECD MTC states in a broad way the scope of application of the DTA, namely “taxes on income and on capital”.<sup>91</sup> As can be gathered from the wording that the

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<sup>82</sup>*Ibid* p 85:8:6.

<sup>83</sup>The Queen v Crown Forest Industries Limited, [1995] 95 DTC 5389 (FCA).

<sup>84</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 4 (2), p 86:9; Commentary on Article 4 (3) p 88:21.

<sup>85</sup>OECD MTC. (2010). Condensed Version, Paris: Article 4 paragraph (2) (a).

<sup>86</sup>*Ibid* Article 4 paragraph (2) (b).

<sup>87</sup>*Ibid* Article 4 paragraph (2) (c).

<sup>88</sup>*Ibid* Article 4 paragraph (2) (d).

<sup>89</sup>*Ibid* Article 4 paragraph (3).

<sup>90</sup>OECD MTC. (2010). Condensed Version, Paris: Article 2.

DTA “shall apply to” the abovementioned taxes. Therefore, the role of this statement is to set a common boundary for the cases of double taxation it is designed to avert and it is not just an introductory sentence. Article 2(1) of the OECD MTC is to be read in conjunction with Article 2(2) of the OECD MTC since it extends on the declaration made in Article 2 (1) of the OECD MTC.

Article 2(2) of the OECD MTC gives a general description of the taxes covered in the DTA.<sup>92</sup> Taxes on income and on capital are described as “all taxes imposed on total income and on total capital, or on elements thereof.”<sup>93</sup> The term “tax” in Article 2 (2) of the OECD MTC does not include social security contributions and fees or user charges imposed by the contracting States governments for the services rendered.<sup>94</sup> The tax must be based on income or capital. It can also be concluded that the manner in which taxes are collected is irrelevant to the DTA application.

The purpose of Article 2 (2) of the OECD MTC in relation to Article 2 (3) and (4) of the OECD MTC is not entirely crystal clear. Article 2 (3) of the OECD MTC list the existing taxes to which ‘in particular’ the DTA applies at the time of signature of the DTA. On the one hand, the list is not exhaustive and “serves to illustrate”, but on the other hand “in principle... it will be a complete list”.<sup>95</sup>

A question that arises is whether the DTA can be applied to a tax that is not listed in Article 2 (3) of the OECD MTC but is covered by the general description of Article 2 (2) and does the DTA apply to a tax that is listed in Article 2 (3) but at the same time clearly outside the scope of Article 2 (2)?<sup>96</sup> This uncertainty may be the reason why some contracting States prefer to omit Article 2 (1) and (3) of the OECD MTC.<sup>97</sup>

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<sup>91</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 2 (1), p 75:2 states that: “This paragraph defines the scope of application of the Convention: taxes on income and on capital...”.

<sup>92</sup>OECD MTC. (2010). Condensed Version, Paris: Article 2 (2).

<sup>93</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 2 (2), p 75:3.

<sup>94</sup>*Ibid.*

<sup>95</sup>*Ibid* Commentary on Article 2 (3), p 76:6.

<sup>96</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 156, marginal note 52.

<sup>97</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 2 (3), p 76:6.1.

Article 2 (4) of the OECD MTC are interconnected to Article 2 (3) of the OECD MTC in that it extends the scope of the DTA beyond the time of its signature. Vogel describes the role of Article 2 (4) by declaring that the provision “takes into account the fact that the treaty text can expressly name only such taxes as exist at the time when the treaty is being concluded.”<sup>98</sup>

The second sentence of Article 2 (4) of the OECD MTC aims at creating for the contracting States an opportunity to amend or through the mutual agreement Article 25 (3) of the OECD MTC, to supplement the DTA, if a new tax does not come within the range of the applicable taxes. Vogel states that this provision is “*a nobile officium*” of the contracting States, which derives from the very conclusion of the DTA and which would exist even if it were not expressly inserted in a DTA.”<sup>99</sup> This clause also avoids the DTA having to be amended in the case of minor changes in the respective domestic tax systems of the contracting States.

## 2.5 Taxation of Income and Capital

Chapter III is headed as “Taxation of Income” and covers the distributive rules regarding income taxes; while Chapter IV head as “Taxation of Capital” contains the distributive rules of wealth income.<sup>100</sup> These chapters, comprising Article 6 through Article 22 of the OECD MC are referred to as “distributive rules” (also known as “classification and assignment rules”).<sup>101</sup> Their function is to allocate amongst the contracting States their respective inherent right to tax under their domestic law. This is achieved by restricting taxation in the source State.<sup>102</sup> Article 9 of the OECD MTC is not a distributive rule, but an anti –avoidance rule.

The purpose of distributive provisions is to categorize the different items of income by sorting and distribute the taxing rights to one or both contracting States.<sup>103</sup> The distributive

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<sup>98</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 156, marginal note 52.

<sup>99</sup>*Ibid* p 158, marginal note 55.

<sup>100</sup>*Ibid* p 29, marginal note 49.

<sup>101</sup>OECD MTC. (2010).Condensed Version, Paris: Introduction, p 11:19.

<sup>102</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 27, marginal note 46. Vogel proposes to use the term “distributive rules” since the term cannot be translated adequately into other languages, which will also be applied in this thesis.

<sup>103</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 100; Victor Uckmar ‘Double Taxation Conventions’ in Amatucci, A. (2006). International Tax Law, p 162.

rules relate to the income, profit or capital (the tax object or event) and not to the taxpayer (the tax subject).<sup>104</sup> The respective distributive rules in Chapter III of the OECD MTC, is not aligned in a systematic structure. They had their arrangement established over the years or by practice.<sup>105</sup>

OECD MTC DTAs operate a scheduler structure under which income is grouped into different income categories with specific DTA source rules. The function of this source rules is to resolve potential source conflicts. The taxing rights over the DTA source rules are assigned through limited or exclusive primary assignment rights to one or both of the contracting States.<sup>106</sup>

The schedular structure of a DTA implies that it is important to first characterize the taxable income to determine which article applies ('income classification rules'). Once the taxable income is characterized the taxable income is subject to the DTA source rules. The taxing rights for each class of income are then assigned to one or both of the contracting States ('assignment rules'). The tax credit or exemption method ('relief principle') is applied by the residence State where both contracting States have a right to tax the income or capital.<sup>107</sup>

## 2.6 Income classification rules

These rules divide the taxable income or capital into different categories with specified taxing rules for each category and are based on activities, assets, or contractual relationships or relate to the alienation of assets.<sup>108</sup>

Category one are articles referring to income from certain activities (active income): Agriculture and forestry (Article 6 OECD MTC), business (Article 7 OECD MTC), independent personal services (Article 14 OECD MTC) and dependent personal services (Article 15 OECD MTC).

Articles in category two are referring to income from certain assets (passive income) or contractual relationship: Immovable property (Article 6 OECD MTC), dividends (Article 10

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<sup>104</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 103.

<sup>105</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 30, marginal note 53.

<sup>106</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 68.

<sup>107</sup>*Ibid* p 100.

<sup>108</sup>*Ibid*.



OECD MTC), interest payments (Article 11 OECD MTC) and royalties (Article 12 OECD MTC).

The third category is an article referring to alienation of assets (capital gains) (Article 13 OECD MTC). The last and fourth category are articles referring to associated enterprises (Article 9 OECD MTC), students (Article 20 OECD MTC) and a catch-all article (Article 21 OECD MTC) which deals with any income not covered by the other articles. As such, it operates as a residual category of income and is necessary because of the schedular nature.<sup>109</sup>

All the other articles of the OECD MTC not mentioned above are *leges speciales* in relation to the four abovementioned general articles. For example, Article 8 (income from transportation) has priority over business income in Article 7 (business profits). Article 16 (directors fees), Article 17 the special taxing rules for international performing artistes and sportsmen), Article 18 (pensions) and Article 19 (government service) trumps Articles 14 (now included in Article 7), and employment income (Article 15).<sup>110</sup>

## 2.7 DTA source rules

DTAs also stipulate the basic source rules to be followed for every class of income or capital by both contracting States. These basic source rules determine the source of income or capital for DTAs purposes, irrespective of the internal tax rules of the contracting States. The basic source rules are specified as follows in OECD MTC DTA:<sup>111</sup>

Type of Income	DTA source rule
Immovable property.	The contracting State where the property is situated ( <i>situs</i> principle).
Business profits and professional services.	Exclusive assignment to the source State where the permanent establishment or fixed based is situated
Shipping, inland waterways transport and air transport.	Assigned to the Contracting states where the effective management of the enterprise is

<sup>109</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 30 – 31, marginal note 53; Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 100.

<sup>110</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 31, marginal note 54.

<sup>111</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 100.



	located.
Government salaries and pensions.	Taxable by the Contracting state of the payer.
Employment services and artistes and sportsman.	Place of work.
Dividends, Interest income and director's fees.	Taxable by the residence State of the payor.
Other income.	It is taxed exclusively by the state making the payment (state of the fund principle).

## 2.8 Assignment rules

The taxing rights for each source of taxable income are allocated to either the source State or the residence State, or to both States. The distributive articles in OECD MTC DTAs apply four types of assignment rules for taxing rights:

- Articles assigning a particular class of income or capital to one State exclusively;
- Articles assigning a class of income or capital to both States;
- Articles assigning a class of income or capital to both States, but limiting the level of taxation in the source State; and
- Articles dealing with the allocation of business profits between related enterprises and the taxation of students.

The following expressions are used to refer to the assignment rules in an OECD MTC DTA:

### 2.8.1 An item of income “shall be taxable only” in a particular contracting State

This is a complete, exclusive distributive rule which gives the residence State the exclusive right to tax the income.<sup>112</sup> The income will be taxed in the residence State and the source State must grant exemptions from tax thus preventing double taxation.<sup>113</sup> However, where the linking factor is the place of effective management or government service in respect of

<sup>112</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 359, marginal note 5.

<sup>113</sup>For example, Article 8 paragraphs 1 and 2, Article 12 paragraph 1, Article 13 paragraphs 3 and 5, Article 15 paragraph 1 and 2, Article 18, Article 19 (1) (a), (b) and 19 (2) (a), (b), Article 21 (1) and Article 22 (3) and (4) of the OECD MTC. See OECD MTC. (2010). Condensed Version, Paris: Commentary on article 23 A and 23 B, p 307: 6 – 308: 7.

remuneration and pensions the source State has the exclusive right to tax and the residence State must give exemption.<sup>114</sup> This distributive rule indicates tax allocation with the absolution allowed by the source State.<sup>115</sup>

### **2.8.2 An item of income “shall be taxable only in the contracting State ...unless”**

This is a complete distributive rule which gives exclusively primary taxing right to the residence State<sup>116</sup> unless there is a permanent establishment<sup>116</sup> or there is a fixed based to perform activities (now deleted Article 14 paragraph (1)) in the source State<sup>117</sup> or the employment income derived in the source State if the physical stay in the source state does not exceed 183 days in any 12 month period or the remuneration is paid by, or on behalf of an employer who is not a resident in the source State and the remuneration is not borne by a permanent establishment in the source State (Article 15 paragraph (1)).<sup>118</sup> This distributive principle applies only if the source State met the compulsory conditions and exercises its non – limited taxing rights.<sup>119</sup>

### **2.8.3 An item of income “may be taxed in that other State”**

This distributive rule grants a limited discretion of taxing right to the source State or the resident State.<sup>120</sup> The residence State must give relief to avoid double taxation. This is an open distributive rule and the result is the application of Article 23 A (1) and (2) and 23 B (1) and accordingly either credit method being allowed or exemption method being used.<sup>121</sup> It gives the source State the preference right to tax if it so wishes, without affecting the existing taxing rights of the residence State.<sup>121</sup>

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<sup>114</sup>See Article 8 paragraphs (1) and (2), Article 13 paragraph (3), Art 19 paragraphs (1) (a) and (2) (a) and Article 22 paragraphs (3). See also Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 358 and 359, marginal note 3.

<sup>115</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 101.

<sup>116</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 359, marginal note 5.

<sup>117</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 7, p 132:10 – 133:14.

<sup>118</sup>*Ibid* Commentary on article 15, p 251:1 – 263:11.

<sup>119</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 101.

<sup>120</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 359, marginal note 4.

<sup>121</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on article 23 A and 23 B, p 308: 7.

#### **2.8.4 An item of income “may be taxed in the other State” but “may also be taxed in the first State”**

This distributive rule does not as a general rule give the exclusive taxing right to both contracting States. This distributive rule limits the taxing right to source State to specify lower rates under the DTA, if the beneficial owner is a resident of the residence State e.g. Article 10 (2) and Article 11 (2). This is also an open distributive rules and the result is the application of Article 23 A (1) and (2) and 23 B (1) and accordingly either credit being allowed or exemption being used.

#### **2.8.5 In one article the expression that an item of income “shall not be taxed”**

This distributive rule provides for a tax exemption. This is a special rule on payments received by students and as such takes precedence over the other rules of the DTA. e.g. Article 20. The residence State, which has the right to tax the worldwide income of its residents, limits its taxing rights for the benefit of the source State. This distributive rule forms the basis for the above-mentioned distribution process.<sup>122</sup>

The distributive rules might be similar to the schedular system under the internal tax laws of various States.<sup>123</sup> However, this comparison must not be endorsed since some of the distributive rules depart more or less from the different internal tax laws. In the United States of America, the schedular system is unknown to its internal tax laws, it rather use a comprehensive definition of income. Thus, following Vogel’s convincing opinion that:

“income designated by treaties, should by no means be confused with those of domestic law, even where they do exist in domestic law; any resemblance that may show up will be superficial and accidental”.<sup>124</sup>

From the legal consequences, one can distinguish between distributive rules with final consequences and such with not final or open consequences.<sup>125</sup> “Final consequences” mean that double taxation is already avoided by the provisions of the distributive rules without necessarily to look to Article 23 A or B of the OECD MTC. Observing the various

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<sup>122</sup>OECD MTC. (2010). Condensed Version, Paris: Articles 6 – 22.

<sup>123</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 30, marginal note 50.

<sup>124</sup>*Ibid* p 30, marginal note 50.

<sup>125</sup>*Ibid* p 30, marginal note 51.

distributive rules, the ones with the final consequences are indicated by the specific wording “shall be only taxable in (...)”,<sup>126</sup> whereas the legal consequences cannot be directly derived from provisions stating that the income “may be taxed in (...)”.<sup>127</sup> The distributive rules do not in principle deal with the determination of taxable income, deductions or tax rates, leaving these questions to internal statutes of the contracting States.<sup>128</sup>

Relief from double taxation is then provided by the provisions laid down in Chapter V of the OECD MTC.

## 2.9 Articles for the methods for eliminating of residual double taxation

Chapter V of the OECD MTC headed as “Methods for Elimination of Double Taxation” regulates the methods to eliminate juridical double taxation where the income or capital is taxed by both contracting States. The relief methods under Article 23 A and 23 B of the OECD MTC apply only to the contracting State where the taxpayer is a resident,<sup>129</sup> except where the taxing rights is in the State where the place of effective management is located<sup>130</sup> or the State which makes payments for government service in respect of remuneration and pensions.<sup>131</sup> The two versions of Article 23 of the OECD MTC sets out two main methods for the elimination of double taxation which can be selected by the residence State, the exemption method (Article 23 A) and credit method (Article 23 B).<sup>132</sup> These two alternative methods apply to both income and capital taxes.<sup>133</sup>

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<sup>126</sup>For example, the general rule of Art 7 paragraph (1) OECD MTC – “Business Profits“: The profits of an enterprise of a contracting State shall be taxable only in that State (...)”.

<sup>127</sup>For example: Art 6 paragraph (1) OECD MTC – Income from immovable Property: “Income derived by a resident of a Contracting State from immovable property (...) situated in the other Contracting State may be taxed in that other State”.

<sup>128</sup>OECD MTC. (2010). Condensed Version, Paris: Commentaries on Article 23A and 23B, p 318: 38.

<sup>129</sup>*Ibid* Commentary on article 23 A and 23 B, p 308: 8.

<sup>130</sup>OECD MTC. (2010). Condensed Version, Paris: Article 8 paragraphs (1) and (2); Article 13 paragraph (3) and Article 22 paragraph (3).

<sup>131</sup>*Ibid* article 19 paragraphs 1 (a) and 2 (a).

<sup>132</sup>Goldberg, H., L. (1983). Conventions for the Elimination of International Double Taxation: Toward a Developing Country Model. Law & Policy in International Business, Volume: 15, p 843.

<sup>133</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on article 23 A and 23 B, p 309:13.

The primary difference between the two methods is that the exemption method exempts the relevant income or capital from the tax base of the State and the credit method starts at the tax.<sup>134</sup> A residence contracting State may use a combination of the two methods.<sup>135</sup> However, it is important to mention that the OECD MTC DTA permits the internal tax law and practice to choose how each of the two methods shall be applied.<sup>136</sup>

Each of the methods of income double taxation elimination has two primary variations.<sup>137</sup> The two most frequently used variations are ordinary tax credit and exemption with progression. Articles 23A and 23B which function in combination with the other distributive articles in the DTA<sup>138</sup> provide that relief be allowed through the exemption or credit method where the provisions of the DTA allow the source State to tax the item of income or capital. If the provision of the DTA lets the source State to tax the item, the residence State has the responsibility to apply the exemption or credit method in connection to the item of income or capital.<sup>139</sup> Article 23 A (1) of the OECD MTC requires that the residence State of the taxpayer must exempt the income or capital from tax.<sup>140</sup> The effect is that the source State has the exclusive right to tax that income.<sup>141</sup>

## 2.10 Ordinary Tax Credit Method

The rule in Article 23 A (2) of the OECD MTC is identical to Article 23 B (1) of the OECD MTC but restricts it to dividends and interest.<sup>142</sup> If this occurs then the state of residence of taxpayer could decide to exempt the dividends or the interest from tax. This restriction of tax in the source State has been enforced in the anticipation that the residence State will make up

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<sup>134</sup>*Ibid* p 309: 17.

<sup>135</sup>*Ibid* p 313: 28.

<sup>136</sup>Rohatgi, R. (2005). Basic International Taxation, Vol. 1, p 176; OECD MTC. (2010). Condensed Version, Paris: Commentary on article 23 A and 23 B, p 313: 28.

<sup>137</sup>Goldberg, H., L. (1983). Conventions for the Elimination of International Double Taxation: Toward a Developing Country Model. Law & Policy in International Business, Volume: 15, p 844.

<sup>138</sup>*Ibid*. See generally the Commentary on Article 6 paragraph 1 p 128 and Article 7 paragraph 1 p 132 -134.

<sup>139</sup>*Ibid* Commentary on article 23 A and 23 B, p 314:32.1.

<sup>140</sup>*Ibid* Commentary on article 23 A and 23 B, p 317:33.

<sup>141</sup>*Ibid* Commentary on article 23 A and 23 B, p 317:33.

<sup>142</sup>*Ibid* Commentary on article 23 A and 23 B, p 321:47.

the level of tax on dividends and interest. Therefore, if the ordinary credit method is applied, the tax burden will first be determined by internal laws as if no DTA existed.<sup>143</sup> However, the tax to be determined has to be reduced by the amount of tax paid abroad on the same income.<sup>144</sup> For instance, if the tax burden in the residence State is higher than in the source State, then the overall tax burden is lifted to the higher tax burden of the residence State.<sup>145</sup> This is called the ordinary credit method which matches the income or capital tax paid in the source State with the tax the income or capital would be subject to in the residence State. If the sum settled in the source State is lower, the difference is paid in tax in the residence State. If the tax paid in the source State is higher, no tax is paid in the residence State.<sup>146</sup>

## 2.11 Exemption with Progression Method

In case of the exemption with progression method, incomes from the source State are not included in the tax base. When the tax is calculated a taxation rate from such tax bracket is used which corresponds to the sum of all incomes or capital, i.e. including those from the source State. This method only applies when the State in question employs progressive system of taxation, wherein tax rates are graded in accordance with the various tax brackets.<sup>147</sup> For example, A is a resident of residence State. A has domestic source income of R800 in residence State and R200 of foreign source income in source State. Under the exemption with progression rate valid in residence State, income below R100 is taxed at 20 per cent and income above that amount is taxable at 30 per cent. Residence State is required, by DTA or internal law, to exempt R100 of income. In determining the tax on the remaining R900 of income residence State is allowed to tax R900 of income at 30 per cent, just as it would have done if all of A's income had been taxable.<sup>148</sup> The consequences of exemption

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<sup>143</sup>*Ibid* Commentary on article 23 A and 23 B, p 321 - 322: 49.

<sup>144</sup>Brian, A. & McIntyre, M. (2002). *International Tax Primer*, p 36 – 37.

<sup>145</sup>*Ibid* p 36.

<sup>146</sup>*Ibid* p 34; OECD MTC. (2010). *Condensed Version*, Paris: Commentary on article 23 A and 23 B, p 322:50 - 52, p 323: 50:53.

<sup>147</sup>OECD MTC. (2010). *Condensed Version*, Paris: Article 23 A (3) and 23 B (2).

<sup>148</sup>Brian, A. & McIntyre, M. (2002). *International Tax Primer*, p 34.

with progression are to take the exempt income into account in determining a resident's ability to pay but applying a zero tax rate to that income.<sup>149</sup>

The exemption with progression method deals only with tax implication of the residence State and not in the source State.<sup>150</sup> This principle of exemption applies to both income and capital exemptions under Article 23 A (1) as well as those articles of the DTA which state that an item of income '*shall be taxable only* in the source State.<sup>151</sup>

Under article 23 A, residence State grants tax exemption with progression to a resident of the source State on all items of income or capital, less dividends and interest income, irrespective of whether they are taxed or not taxed in the source State.<sup>152</sup> The residence State is permitted not to tax the dividends and interest income, but if it desires to tax the dividends and income, it has to use the credit method and not the exemption method.<sup>153</sup>

The exemption method ensures that a taxpayer who is investing in the source State has the same tax implications as his competitors doing business in the source State. The residence State, in fact apart from the progression does not tax at all. Therefore, the tax level of the source State is conclusive. However, if it can be found that, the tax implications in the residence State is higher than in the source State, then the tax implications of the residence State is conclusive.

## 2.12 Miscellaneous or Special Articles

Chapter VI of the OECD MTC contains additional articles regarding non-discrimination,<sup>154</sup> mutual agreement procedure,<sup>155</sup> an exchange of information,<sup>156</sup> a reservation for the tax privileges of members of diplomatic missions and consular posts,<sup>157</sup> and a provision which

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<sup>149</sup>*Ibid.*

<sup>150</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on article 23 A and 23 B, p 323: 56.1.

<sup>151</sup>*Ibid* Commentary on article 23 A and 23 B, p 323: 55.

<sup>152</sup>*Ibid* Commentary on article 23 A and 23 B, p 317: 34.

<sup>153</sup>*Ibid* Commentary on article 23 A and 23 B, p 321:47.

<sup>154</sup>OECD MTC. (2010). Condensed Version, Paris: Article 24 Non-Discrimination.

<sup>155</sup>*Ibid* Article 25 Mutual Agreement Procedures.

<sup>156</sup>*Ibid* Article 26 Exchange of Information.

<sup>157</sup>*Ibid* Article 28 Members of Diplomatic Missions and Consular Posts.



extends the DTA to dependent territories,<sup>158</sup> which is considered to provide remedy in case of doubts, differences of judgment and, in any remaining cases of juridical double taxation.

The power granted by Article 25(3) of the OECD MTC to competent authorities to resolve difficulties of interpretation not provided for in the DTA is closely linked to the fundamental purpose of DTAs. The competent authorities must truly fulfill this determination by their willingness to exercise that authority in relevant cases, provided there is no internal law obstacle to doing so.<sup>159</sup>

### **2.13 Final Provisions**

Chapter VII of the OECD MTC covers the final provisions regarding the entry of force<sup>160</sup> and the termination<sup>161</sup> of DTAs. Often, final protocols and no other concluding documents are attached to DTAs. Their purpose is to elaborate and complete the text of a DTA. Sometimes they even modify the text of the DTA.<sup>162</sup> Since they have the same legal impact as the agreed DTA and for the fact that they are of the same binding nature, they must not be forgotten when dealing with DTAs.<sup>163</sup>

### **2.14 Ordering rules in a DTA interaction between Article 7 OECD MC and others categories of income**

Where income falls under more than one distributive rule, then distributive rules referring to income from passive income take precedence over those governing income from business income.<sup>164</sup> In such circumstances, it is necessary for a DTA to contain some priority rules that establish which provision takes precedence in taxing the income. Article 7 (4) (business profits) of the OECD MTC DTA states that:

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<sup>158</sup>*Ibid* Article 29 territorial extensions.

<sup>159</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on article 25, p 369: 50, 51.

<sup>160</sup>OECD MTC. (2010). Condensed Version, Paris: Article 30 Entry into force of the DTA.

<sup>161</sup>*Ibid* Article 31 Termination of a DTA.

<sup>162</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 32, marginal note 57.

<sup>163</sup>*Ibid*.

<sup>164</sup>*Ibid* p 359, marginal note 5.



“where business profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article (emphasis added).”

Therefore, special distributive rules on certain items of business income (Article 6, 10, 11 and 12 OECD MTC as well as the Article 13 on capital gains) will *prima facie* take priority over the rules in Article 7 OECD MTC if the income from immovable property, dividends, interest and royalties also constitute business profits.<sup>165</sup> It should however be noted Article 7 OECD MTC takes precedence over the special distributive rules where the income relates to a permanent establishment (‘PE’) proviso (Articles 10 (4), 11(4), 12 (3), – 13 (2) and 21 (2)). The primary taxing rights will be assigned to the PE State rather than the residence State.<sup>166</sup>

## 2.15 The Application and Operation of a OECD MTC DTAs

The operation process of a DTA is divided into a chain of phases, involving the different types of articles.<sup>167</sup> The starting point will be to determine whether the income or capital is due in terms of the domestic legislation of the State in which the payor is situated and provided there is no exemption in terms of an applicable DTA entered between contracting States.<sup>168</sup> Then the process is as follows:

- The first step will be to determine whether the taxpayer is within the personal scope of Article 1 OECD MTC.<sup>169</sup> It would also be worthwhile to examine whether the taxpayer is a “person” within the meaning of Article 3 (1) (a) of the OECD MTC and a “resident of a Contracting State” according to Article 4 (1) of the OECD MC.<sup>170</sup>
- The second step is to determine whether it is a tax listed in Article 2 of the OECD MTC or a tax substantively similar to such a tax.<sup>171</sup> What must also be inquired is

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<sup>165</sup>*Ibid* p 401, marginal note 8a.

<sup>166</sup>*Ibid* p 401, marginal note 8a.

<sup>167</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16, B -20.

<sup>168</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 31, marginal note 56.

<sup>169</sup>*Ibid* p 28 marginal note 48, Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16, B -20.

<sup>170</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16, B -20.

<sup>171</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 28, marginal note 48.

whether the DTA is in force (Article 29 OECD MTC) and has not been terminated (Article 30 OECD MTC).<sup>172</sup>

- The third step is to apply the relevant definitions.<sup>173</sup> If the taxpayer is a resident of both contracting States, the tie-breaker rule in Article 4 (2) and (3) of the OECD MTC must be applied to determine a solitary residence for DTA purposes. Article 5 OECD MTC is important when it is necessary to determine whether a taxpayer has a PE in a State.<sup>174</sup>
- The fourth step is to determine which of the distributive rules is applicable to the different categories of income, capital or capital gains.<sup>175</sup>

Then apply the applicable distributive article as follows:

- (a) Exclusive source State taxation without restriction<sup>176</sup>

Income from house property situated in that source or *situs*<sup>177</sup> and business profits derived from a PE in the source State.<sup>178</sup>

- (b) Source State may tax but subject to specific limits<sup>179</sup>

The DTA states the maximum to the level of taxation the source State can tax. This income includes dividends<sup>180</sup> and interest derived from source State.<sup>181</sup> The residence State may also elect to tax the same income, but must provide relief, in terms of the DTA, in the form of either a tax credit (Article 23B) or a total exemption in the resident country (Article 23A).

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<sup>172</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16, B -20.

<sup>173</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 29, marginal note 49.

<sup>174</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16, B -21.

<sup>175</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 29, marginal note 49; Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 16 B -22.

<sup>176</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 281.

<sup>177</sup>OECD MTC. (2010). Condensed Version, Paris: Article 8.

<sup>178</sup>*Ibid* Article 7 (1).

<sup>179</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 281.

<sup>180</sup>OECD MTC. (2010). Condensed Version, Paris: Article 10 (2).

<sup>181</sup>*Ibid* OECD Article 11 (2).

(c) Exclusive residence State taxation<sup>182</sup>

The residence State has a worldwide tax basis for its residents i.e. Business profits where there is no PE in the source State.<sup>183</sup>

- The next step is to apply Article 23 A and B of the OECD MTC which sets out the methods for the elimination of double taxation which must be taking into consideration with each of the distributive articles.

The general consent is that the source State has the main prerogative to tax active income (business income and income from services) and restricted prerogative to tax passive income (royalties, interest, capital gains, dividends).<sup>184</sup> The residence State has the residual prerogative to tax the income that is subject to restricted source taxation and also has exclusive prerogative to tax international shipping and air transportation income.<sup>185</sup>

## 2.16 Concluding remarks

This chapter has investigated the structure of a typical OECD MTC DTA and broke the DTA structure down into categories of articles covering those dealing with the application of the DTA, those setting out the DTAs distributive rules; those targeted at the prevention of tax avoidance and fiscal evasion; and those dealing with miscellaneous matters. We have look also at the ordering rules and the process of DTA operation.

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<sup>182</sup>Olivier, L. & Honiball, M. (2011). *International Tax: A South African Perspective*, p 281; Baker, P. (1994). *Double Taxation Conventions and International Tax Law*, p 18, B -23.

<sup>183</sup>*Ibid* Article 7 (1).

<sup>184</sup>*Ibid* Article 11.

<sup>185</sup>*Ibid* Article 20.

## **3 CHAPTER 3: GENERAL PRINCIPLES GOVERNING THE INTERPRETATION OF DTAs UNDER INTERNATIONAL LAW**

### **3.1 Introduction**

This chapter deals with the international approach to DTA interpretation. However, there is no international judicial authority to interpret DTAs.<sup>186</sup> The domestic courts of the contracting States are required to interpret DTAs.<sup>187</sup> An argument to be made at the beginning is that the interpretation of DTA is a subject in itself and not merely an extension of internal law interpretation. This is beside the fact that DTAs can only be enforceable when domesticated via internal statutory law of the contracting States.<sup>188</sup>

### **3.2 The interpretation of DTA under the Vienna Convention on the Law of Treaties ('VCLT')**

DTAs have the characteristics of international agreements that are concluded between contracting States under public international law and international agreements are interpreted in consonance with the principles of customary international law.<sup>189</sup> Therefore, it is widely accepted that DTAs formation and legal consequences are determined by the rules of interpretation contained in the VCLT.<sup>190</sup> The principle of *pacta sunt servanda* or principle of good faith implies that contracting States cannot have an intended to deviate from their existing obligations when concluding a new treaty.<sup>191</sup> The principle is also confirmed in Article 31(1) of the VCLT on the interpretation of treaties. This interpretational rule under international law does not differ from the method of interpretation that is used under domestic

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<sup>186</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 56.

<sup>187</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 33, marginal note 59.

<sup>188</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 56.

<sup>189</sup>Lang, M. &Brugger, F. (2008). The Role of the OECD Commentary in Tax Treaty Interpretation, Australian Tax Forum, Volume: 23, p 97; Calderon, J., M, Piña, M.,D. (1999). Interpretation of Tax Treaties, International Bureau of Fiscal Documentation, European Taxation, p 378; Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 35, marginal note 68.

<sup>190</sup>Calderon, J., M, Piña, M., D. (1999). Interpretation of Tax Treaties, International Bureau of Fiscal Documentation, European Taxation, p 378; Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 21, marginal note 28.

<sup>191</sup>Vienna Convention on the Law of Treaties.(1969). Article 26.

law. If the emphasis of DTA interpretation is on the ordinary meaning of the text, then the textual or literal interpretation applies but, if the prominence is on the context, then contextual or systematic interpretation and if the emphasis falls primarily on the object and purpose of the treaty, reference is made to a teleological interpretation approach.<sup>192</sup>

The VCLT set out the rules for interpretation of treaties which become part of customary international law i.e. general practice accepted as law.<sup>193</sup> These rules of treaty interpretation are laid down in Articles 31 to 33 of the VCLT. The starting point is article 31 (1) of the VCLT which lays down the general method of interpretation of DTA terms. The article states that:

“A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.<sup>194</sup>

Article 31 (1) of the VCLT contains three separate principles, namely: (1) good faith which is directly linked to the principle of *pacta sunt servanda* in Article 26 of the VCLT); (2) the words in the treaty should be given their ordinary meaning and (3) the ordinary meaning should be determined not in isolation, taking into account the context as read in the light of the object and purpose of the DTA.<sup>195</sup> This Article requires for a textual or literal interpretation approach of a DTA.<sup>196</sup> The ordinary meaning of the words as stated in the text is the beginning point of the interpretation procedure, as the transcribed text of the DTA represents the authentic expression of the contracting States.<sup>197</sup> The principle of good faith in Article 31 (1) of the VCLT establishes a closer link to the principle of *pacta sunt servanda*. This means that contracting States should in principle interpret their DTAs without

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<sup>192</sup>Schaffer, R. P. (1976). Current Trends in Treaty Interpretation and the South African Approach, Australian Yearbook of international Law, Issue 129, Volume: 7, p 130; Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 31.

<sup>193</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 39.

<sup>194</sup>Vienna Convention on the Law of Treaties. (1969). Article 31 (1).

<sup>195</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 40.

<sup>196</sup>Lang, M. &Brugger, F. (2008). The Role of the OECD Commentary in Tax Treaty Interpretation, Australian Tax Forum, Volume: 23, p 99.

<sup>197</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 40.

contravening their provisions or evading their implementation.<sup>198</sup> Contracting States when interpreting in good faith must always look forward to ensure that the object and purpose of the DTA are complied with.

Concerning the ordinary meaning of the terms used in the DTA, they are not the everyday use as in internal law. The reason being that as DTAs are international agreements, the ordinary meaning will be those terms developed between the contracting States as an accepted worldwide constant legitimate usage.<sup>199</sup> However, it is not clear if there is such an international tax language, an expression commonly used international tax literature.

In order to establish the ordinary meaning, special attention should be given to the context, the object and the purpose of the DTA.<sup>200</sup> The term “context” includes the entire text of the DTA, including the preamble and annexes. It also include any other agreement or instruments such as protocols to a DTA, exchanges of letters between the contracting States or explanations or memoranda of understanding which often clarify a matter after the DTA was initially signed.<sup>201</sup>

The term “context” in these conditions is not a complete term, but a comparative term. It is used to influence the meaning of a term or a phrase. Context will be provided by a DTA term, phrase or provision in relation to some other DTAs’ term.<sup>202</sup> Therefore, for the VCLT, the purpose of “context” includes the whole structure of the DTA. It can also be argued that by including the context of the DTA in its own text, preamble, annexures and protocol, that this context based interpretation leads to a treaty systematic interpretation approach.

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<sup>198</sup>Vienna Convention on the Law of Treaties. (1969). Article 26.

<sup>199</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 37, marginal note 70.

<sup>200</sup>Schaffer, R, P. (1976). Current Trends in Treaty Interpretation and the South African Approach, Australian Yearbook of international Law, Issue 129, Volume: 7, p 139.

<sup>201</sup>Vienna Convention on the Law of Treaties. (1969). Article 31 (2).

<sup>202</sup>Van der Bruggen, E. (2003). Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3 (2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties, International Bureau of Fiscal Documentation, European Taxation, No.5, Volume: 43, p 143.

The term object and the purpose of a DTA do not provide an independent method of interpretation of separate DTA terms.<sup>203</sup> The object and the purpose is one provision that defines one object and do not have different meanings.<sup>204</sup> The treaty textual method of interpretation determines the object and purpose of a DTA. The intention of the contracting States is only relevant ‘to the extent that the intent is reflected in the written text of the DTA’.<sup>205</sup>

Article 31(1) and (2) of the VCLT determine what can be considered part of the context and what other elements can be considered together with the context. However, Article 31 (3) requires that together with the context any outside and additional interpretative essentials must be taken into consideration together with the pre-determined context for interpretation purposes.<sup>206</sup> Article 31 (1) of the VCLT refers to agreements or interpretation methods established after the DTA conclusion, while Article 31 (2) refers to the interpretation of agreements established by the contracting States at the moment the DTA was concluded.

Therefore, the focus of Article 31 (1) to (3)<sup>207</sup> is to establish the ordinarily meaning of a term in its rather narrowly defined context. The provisions in the above-mentioned articles are fairly complete and are likely to ignore supplementary material, such as the OECD MC Commentaries.<sup>208</sup> However, Articles 31 (4) and 32 of the VCLT extend the remit of Article 31 (1) to (3) of the VCLT.

Article 31 (4) of the VCLT allows a special meaning to be given if it is established that the contracting States intended so. This special meaning may be characterized by those definitions contained in the DTA which establish the meaning of a sequence of terms.<sup>209</sup> Other interpretation sources are allowed if the outcome remains “ambiguous, obscure,

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<sup>203</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 41.

<sup>204</sup>*Ibid* p 41.

<sup>205</sup>*Ibid* p 41.

<sup>206</sup>Vienna Convention on the Law of Treaties. (1969). Article 31 (3) (a), (b), (c).

<sup>207</sup>*Ibid*.

<sup>208</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 42.

<sup>209</sup>For example, permanent establishment (Article 5 (2)), dividends (Article 10 (3)), interest (Article 11 (3)) and royalties (Article 12 (2) of the OECD MTC).



contradictory, unreasonable or absurd”.<sup>210</sup> Article 32 of the VCLT remains strictly a secondary method of treaty interpretation, as historical sources are often untrustworthy or selectively used by contracting States to resolve a dispute. Article 32 only allows limited use of unnecessary supplementary material.

The interpretations of bilingual or multilingual DTAs are dealt with in Article 33 of the Vienna Convention.<sup>211</sup> This provision is important due to the fact that majority of DTAs are drafted in and usually authenticated in at least two languages. Article 33 (4) of the VCLT provides that any doubts originating from a comparison between the authenticated texts shall be settled by means of the methods as laid down in Article 31 and 32 of the VCLT in the absence of a prevailing language. Should the problem fail to be settled by this means, the article makes it clear that the meaning that best reconciles the text should be adopted and that the object and purpose of the DTA shall be taken into account.<sup>212</sup>

In summary the interpretation of DTAs may be overwhelmed with various problems of technicalities and fiscal terminologies. However, the textual approach under the VCLT helps to overcome such problems.

### **3.3 Importance of interpretation under the OECD MTC Commentaries**

The courts of different States use the OECD MTC Commentaries when a uniform interpretation is required by a DTA<sup>213</sup> or when a definition of a term in a DTA and the OECD MTC is identical.<sup>214</sup> The OECD MTC Commentaries are also used by taxpayers as well as tax authorities for the interpretation of DTAs. In the field of international taxation, the OECD MTC Commentaries are considered to be the best international practice, which is sometimes referred to as “international tax language”.<sup>215</sup> When there is no definition of the term in the

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<sup>210</sup>Vienna Convention on the Law of Treaties. (1969).Article 32.

<sup>211</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 42.

<sup>212</sup>Victor Uckmar ‘Double Taxation Conventions’ in Amatucci, A. (2006). International Tax Law, Kluwer International Law, p 158.

<sup>213</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 43, marginal note 79; Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 43.

<sup>214</sup>HMRS v Smallwood and Others (2010) EWCA CIV 778, para 98.

<sup>215</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 37, marginal note 70.



DTA and the internal law definition of the term is the same as the definition of the OECD MTC, the OECD MTC Commentaries can be useful.

It is therefore necessary to determine the extent to which the OECD MTC Commentaries can be used for the purposes of interpretation of DTAs. The OECD MTC Commentaries is seen a useful method of interpretation for OECD MTC DTAs as it contains the intention of the contracting States at the time of the OECD MTC DTA negotiation. The assumption is that the DTA negotiators wanted a specific OECD MTC DTA provisions to express the meaning in the OECD MTC Commentaries, which they may have had in front of them, or may have known at the time of negotiating of the OECD MTC DTA.

### **3.4 The Legal Status of the OECD MTC Commentaries**

Every publication of the OECD Model<sup>216</sup> from the 1963 draft through to the 2010 draft has been accompanied by extensive Commentaries on each of the Articles contained in the OECD MTC.<sup>217</sup> Since 1992 the OECD Model and the Commentaries have been updated on a regular basis,<sup>218</sup> bringing an increasingly changes and additions to the original text of the Commentaries to the 1963 OECD Model.<sup>219</sup>

The OECD MTC and its Commentaries are the work of the OECD Committee on Fiscal Affairs ('CFA').<sup>220</sup> The CFA is comprised of senior government officials from the OECD member States.<sup>221</sup> They play an active role in formulating and implementing tax policies in their respective States. They also consult on frequent basis with business and with other international and regional tax organizations.<sup>222</sup>

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<sup>216</sup>OECD MTC. (2010). Condensed Version, Paris.

<sup>217</sup>Lang, M. & Brugger, F. (2008). The Role of the OECD Commentary in Tax Treaty Interpretation, Australian Tax Forum, Volume: 23, p 96.

<sup>218</sup>OECD MTC. (2010). Condensed Version, Paris, Introduction, p 9: 11.

<sup>219</sup>Changes were made to the OECD MTC Commentaries in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008 and 2010.

<sup>220</sup>Lang, M. & Brugger, F. (2008). The Role of the OECD Commentary in Tax Treaty Interpretation, Australian Tax Forum, Volume: 23, p 96.

<sup>221</sup>Olivier, L. & Honiball, M. (2011). International Tax: A South African Perspective, p 269.

<sup>222</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 43, footnote 88.

The 'condensed' version of the OECD MTC Commentary is a detailed document.<sup>223</sup> It contains of the authoritative interpretative material and it also included reservations which both member and non-member States of the OECD have to express their disagreement with certain aspects. These reservations to articles and observations to the Commentaries allowed States to be able to express their disagreement with certain aspects of the OECD MTC. They also details additional provisions which contracting States intend to include on positions on articles and Commentaries in future OECD MTC DTAs.<sup>224</sup>

The OECD MTC Commentaries has gain increasing importance in the interpretation of DTAs<sup>225</sup> and they offer an important source of interpretation for courts of different contracting States to pursue a shared interpretation of DTAs.<sup>226</sup> It provides a collective structure which OECD member States use while negotiating and drafting their respective DTA.<sup>227</sup> It is not only used by OECD member States as a principal and reliable tool of interpretative of their DTA, but also states which follow the UN and US Model Conventions. This is because the UN and US Models are basically adaptations of the OECD MTC.<sup>228</sup> The OECD MTC Commentaries are only a persuasive factor for non – member States in DTAs interpretation.<sup>229</sup> For OECD member States the introduction to the OECD MTC Commentary noticeably states:

“... although the Commentaries are not signed to be annexed in any manner to the conventions signed by member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and, in particular in the settlement of any disputes”.<sup>230</sup>

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<sup>223</sup>OECD MTC. (2010). Condensed Version, Paris.

<sup>224</sup>*Ibid.*

<sup>225</sup>OECD MTC. (2010). Condensed Version, Paris: Introduction, p 9: 9.

<sup>226</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 43, marginal note 79.

<sup>227</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 43; Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 4, A -06.

<sup>228</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 43.

<sup>229</sup>*Ibid.*

<sup>230</sup>OECD MTC. (2010). Condensed Version, Paris, Introduction p14: 29.

It has been the long-standing practice of the OECD council to recommend to its member States that, when concluding DTA on income and capital, they should do so in the form of the OECD MTC.<sup>231</sup> It has also been its long-standing recommendation that OECD member States follow the OECD MTC Commentaries which have been prepared on the Articles of the OECD MTC as modified from time to time when applying and interpreting the provisions of their DTAs.<sup>232</sup> The OECD MTC Commentaries have been referred to as an interpretation aid of DTA texts by the courts in Australia, Belgium, Denmark, Germany, Japan, Netherlands, New Zealand, Sweden, Switzerland, United Kingdom and the United States of America.<sup>233</sup>

### 3.5 The role of OECD MTC Commentaries in DTA interpretation

There is no generally accepted understanding as to where the OECD MTC Commentaries fits within the rules of interpretation referred to in Articles 31 and 32 of the VCLT.<sup>234</sup> There is a view that the OECD MTC Commentaries constitute part of the ‘context’ in Article 31 of the VCLT.<sup>235</sup> The OECD MTC Commentaries could also qualify as a supplementary means of interpretation under Article 32 of the VCLT, provided that the DTA are based on the OECD MTC and its Commentaries.<sup>236</sup> This understanding gets its backing from the fact that during drafting procedure the OECD member States have an opportunity to note their observations. The absence of such an observation or reservations by member States means that the OECD MTC Commentaries must be applied unless the member States object or the adoption of a specific DTA provision will be an infringement to its internal statutory law.<sup>237</sup>

Another view is that if the contracting States are members of the OECD there is at least some form of soft-law obligation<sup>238</sup> for them to follow the OECD MTC Commentaries, since the

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<sup>231</sup>Baker, P. (1994). *Double Taxation Conventions and International Tax Law*, p 3, footnote 9.

<sup>232</sup>*Ibid* p 4, A -06.

<sup>233</sup>*Ibid* p 28, C-12.

<sup>234</sup>Vogel, K. (1997). *Double Taxation Conventions Kluwer Law International*, p 44, marginal note 79a – 80.

<sup>235</sup>*Ibid* p 213 – 215, marginal note 68 -74.

<sup>236</sup>Lang, M. & Brugger, F. (2008). *The Role of the OECD Commentary in Tax Treaty Interpretation*, Australian Tax Forum, Volume: 23, p 98.

<sup>237</sup>Vogel, K. (1997). *Double Taxation Conventions Kluwer Law International*, p 45, marginal note 80.

<sup>238</sup>*Ibid* p 44, marginal note 80.

OECD council suggested to its member States in two important recommendations.<sup>239</sup> According to this view the OECD MTC Commentaries form part of the context under the VCLT and they are not just a supplementary means of interpretation.<sup>240</sup> Regarding the interpretation of OECD MTC DTAs between OECD member States the following broad suggestions can be detected:<sup>241</sup>

- If the text of the OECD MTC is approved without any changes, it will be expected that the contracting States intended to follow the OECD Council's recommendation. Therefore both the OECD MTC and its Commentaries are essential.
- If the text of the OECD MTC is not accepted literally, but a wording is follow that required an interpretation consistent with the OECD MTC, it can be alleged that an interpretation consistent with the OECD MTC Commentaries should apply.
- If the text of the OECD MTC is entirely ignored, the OECD MTC Commentaries may be overlooked.

The view of the OECD Committee on Fiscal Affairs on the OECD MTC Commentaries is that the Commentaries are of distinctive significance in the improvement of international fiscal law.<sup>242</sup> They are also of the view that it can be of unlimited help in the application and interpretation of the OECD MTC DTAs and in specific, for the settlement of any differences.<sup>243</sup>

### **3.6 Static versus Ambulatory interpretation of the OECD MTC Commentaries**

Amendments to the OECD MTC and its Commentaries are made on a continuing basis, since the 1992 draft.<sup>244</sup> This raises the question whether a OECD MTC DTA should be interpreted by reference to the relevant OECD MTC Commentaries as it is read at the time the DTA was

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<sup>239</sup>Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 17- 18, marginal note 19; OECD MTC. (2010). *Condensed Version*, Paris: Introduction, p 9:13.

<sup>240</sup>Rohatgi, R. (2005). *Basic International Taxation*, Volume: 1, p 44.

<sup>241</sup>Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 45, marginal note 81.

<sup>242</sup>OECD MTC. (2010). *Condensed Version*, Paris: Introduction, p 14: 29.

<sup>243</sup>*Ibid.*

<sup>244</sup>Lang, M. & Brugger, F. (2008). *The Role of the OECD Commentary in Tax Treaty Interpretation*, *Australian Tax Forum*, Volume: 23, p 101; OECD MTC. (2010). *Condensed Version*, Paris: Introduction, p 9: 9.

concluded (static interpretation) or at the time the need for interpretation (ambulatory interpretation) arises.

The existing articles are to be interpreted in the spirit of the revised Commentaries.<sup>245</sup> Materials of the OECD MTC Commentaries written after signing of a DTA have only persuasive value.<sup>246</sup> The Special Commissioners in *Trevor Smallwood Trust v Revenue and Customs Commissioners*<sup>247</sup> held that the correct publication of the OECD MTC Commentaries to use was the one at the time a need for interpretation arises rather than the one in force at the time the DTA was signed. This point is also confirmed in the introduction to the OECD MTC Commentaries.<sup>248</sup> According to the OECD, the justification for this reasoning is that those changes to the OECD MTC Commentaries reflect the consensus of the member States.<sup>249</sup> This confirms that the OECD MTC Commentaries are now an ambulatory document.<sup>250</sup>

### **3.7 The relationship of the OECD MTC Commentaries to the VCLT**

There is confusion as to what is the relationship of the OECD MTC and its Commentaries to the rules of treaty interpretation under the VCLT. Courts have made references to the OECD MTC and its Commentaries in the interpretation of DTAs.<sup>251</sup> The use of the OECD MTC Commentaries for the interpretation of DTAs many either fit in within the provisions of Articles 31 and 32 of the VCLT.<sup>252</sup> In accordance with Vogel if OECD member States signed a DTA based on the OECD MTC it is accepted that the contracting States want the DTA provisions to bear the meaning intended by OECD MTC and its Commentaries. It is then regarded as the ‘ordinary meaning’ of the DTA as alluded under Article 31 (2) of the

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<sup>245</sup>OECD MTC. (2010). Condensed Version, Paris: introduction, p 15:33 – 35.

<sup>246</sup>*Ibid* p 16: 36.

<sup>247</sup>[2008] STC (SCD) 629, par 99; Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 45.

<sup>248</sup>OECD MTC. (2010). Condensed Version, Paris: Introduction, p 15: 33 -35.

<sup>249</sup>*Ibid* p 15: 35.

<sup>250</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 45.

<sup>251</sup>OECD MTC. (2010). Condensed Version, Paris: Introduction, p 14: 29.3.

<sup>252</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 44.

VCLT.<sup>253</sup> The OECD MTC and its Commentaries may also create a special meaning within the provisions of Article 31 (4) of the VCLT.<sup>254</sup> If it is proved that it was the intention of the contracting States then a special meaning will be given to a term.

Another possibility is that the OECD MTC and its Commentaries may be regarded as a supplementary means of interpretation under Article 32 of the VCLT.<sup>255</sup> The problem with this approach is that the consequence is narrow to ratify a meaning already established under Article 31 of the VCLT or to determine the meaning where Article 31 of the VCLT is ambiguous or obscure, or leads to an absurd or unreasonable result. They may also be used to determine the special meaning in Article 31 (4) of the VCLT.<sup>256</sup>

South African courts *de facto* rely on the OECD MC and its Commentaries and consider it a substantial source of law.<sup>257</sup> There is still no consensus amongst legal scholars as to what are the legal implications of the OECD MTC Commentaries to the VCLT.<sup>258</sup> The OECD MTC Commentaries are still useful for interpreting of OECD MTC DTAs, even if they cannot be built-in under the rules of the interpretation of the VCLT.

### **3.8 Interpretation under Article 3 (2) of the OECD MTC**

In addition to the provisions of the VCLT, OECD MTC DTAs contains an internal rule of treaty interpretation that is similar or identical to Article 3 (2)<sup>259</sup> which reads at present as follows:

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<sup>253</sup>Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 44, marginal note 80.

<sup>254</sup>Rohatgi, R. (2005). *Basic International Taxation*, Volume: 1, p44.

<sup>255</sup>Avery Jones, J. F. (1993). Article 3 (2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, *International Bureau of Fiscal Documentation, European Taxation*, No. 8, Volume: 33, p 255.

<sup>256</sup>Lang, M. & Brugger, F. (2008). The Role of the OECD Commentary in Tax Treaty Interpretation, *Australian Tax Forum*, Volume: 23, p 97 - 98.

<sup>257</sup>SIR v Downing 1975 (4) SA 518 (A) at 525; ITC 1544 54 SATC 456 (T) at 463; ITC 1735 64 SATC 455 464.

<sup>258</sup>Rohatgi, R. (2005). *Basic International Taxation*, Volume: 1, p 44.

<sup>259</sup>As far as Art 3 (2) of the OECD MTC is concerned see in general Avery Jones, J.F., Berg, C.J., Depret, H.R., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A.(1984). *The Interpretations of Tax Treaties with Particular Reference Article 3 (2) of the OECD Model*. *British Tax Review* (Part 1 & 2); Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 208 – 217,

“As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State”.<sup>260</sup>

Article 3 (2) confirms the view that there is a special relationship between a DTA and the domestic taxation laws of the contracting States. It acknowledges the fact that a DTA operates with the internal tax laws of the contracting States in which it applies and does not exist in a legal void. Article 3 (2) also preserve the tax autonomy of the contracting States.<sup>261</sup>

To taxpayers, tax authorities and courts, Article 3 (2) has practical advantages as reference to the internal law promotes legal certainty. The other advantage is that Article 3 (2) prevents the DTA from be overloaded with definitions that would render its application difficult.<sup>262</sup>

The reference to the domestic law in Article 3 (2) of the OECD MTC may pose interpretation problems in that the two contracting States may assign different meanings to terms when they are applying the DTA.<sup>263</sup> This may have the effect of double taxation elimination or double non-taxation.<sup>264</sup> As Article 3 (2) functions in regard to “the application of the Convention at any time by a Contracting State”<sup>265</sup> the problem of double taxation or double non – taxation might have been resolve. It is the source State that applies Article 3 (2); the residence State must only state that the source State has levied tax in agreement with the provisions of the DTA when providing double taxation relief.<sup>266</sup>

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marginal note 57 -78; Baker, P. (1994). *Double Taxation Conventions and International Tax Law*, p 31 – 39, C – 18 – C – 27.

<sup>260</sup>OECD MTC. (2010). *Condensed Version*, Paris: Article 3 (2).

<sup>261</sup>Vogel, K. (1997). *Double Taxation Conventions Kluwer Law International*, p 209, marginal note 60a.

<sup>262</sup>Avery Jones, J. F. (1993). Article 3 (2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, International Bureau of Fiscal Documentation, *European Taxation*, No. 8, Volume: 33,p 252.

<sup>263</sup>Vogel, K. (1997). *Double Taxation Conventions Kluwer Law International*, p 208, marginal note 60.

<sup>264</sup>*Ibid* p 208 – 209, marginal note 60.

<sup>265</sup>OECD MTC. (2010). *Condensed Version*, Paris: Article 3 (2).

<sup>266</sup>Vogel, K. (1997). *Double Taxation Conventions Kluwer Law International*, p 211 – 212, marginal note 65.



In international law, the provision of Article 3 (2) is referred to as an interpretative clause, which consists of a list of definitions or terminologies. Contracting States to DTAs include an interpretative clause in a DTA to declare their interpretation that they want to define certain DTA terms.<sup>267</sup> It is a dependent rule, because its task is primarily to refer to other vital rules in a DTA.<sup>268</sup>

Article 3 (2) is being also considered as a general rule of interpretation with respect to the special DTA article definitions contained in Article 11 (3) (interest) and Article 12 (2) (royalties) and definitions of meanings of subsequent terms in Article 4 (1) (“resident of a Contracting State”); Article 5 (2) (permanent establishment); Article 6 (2) (immovable property) and Article 10 (3) (dividends) of the OECD MTC under the internal law of the contracting States. Each of these definitions has priority over the *general revoi clause* contained in Article 3 (2).<sup>269</sup> Article 3 (2) is also a special rule of interpretation in relation to the general rules of interpretation of DTAs and as such takes priority over such general rules.<sup>270</sup> Therefore, undefined terms such as beneficial owner, effective management, partnership and pension could follow the domestic tax law definition, unless the context of the DTA requires a different meaning.<sup>271</sup>

As a special rule of interpretation, the operation of Article 3 (2) is restricted. The rule in Article 3 (2) governs only the interpretation of terms that are used in the DTA. It does not provide for the closing of loopholes contained in DTAs.<sup>272</sup> It also refers only to the meaning of the term in question according to the domestic law of the contracting State concerning “the taxes to which the Convention applies”.<sup>273</sup> It thus wants the term be applied by the law

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<sup>267</sup>Van der Bruggen, E. (2003). Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3 (2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties, International Bureau of Fiscal Documentation, European Taxation, No.5, Volume: 43, p 143.

<sup>268</sup>*Ibid* p 143.

<sup>269</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 211, marginal note 63.

<sup>270</sup>*Ibid* p 209, marginal note 61.

<sup>271</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 50.

<sup>272</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 209, marginal note 62.

<sup>273</sup>*Ibid* p 210, marginal note 62.



regarding these taxes, and not simply by any internal branch of law.<sup>274</sup> The general principles regarding qualification will apply and not Article 3(2) if the term has no distinct legal meaning or if a term is only defined in private law or in any tax law other than income or capital tax law.<sup>275</sup>

### **3.9 The meaning of some the expressions in Article 3 (2) of the OECD MTC**

#### **3.9.1 The meaning of the term ‘Application’**

The interpretation of the term “application” as contained in the text of Article 3 (2) of the OECD MTC DTA gives rise to interpretation issues.<sup>276</sup> Vogel defines application as:

“every decision of a tax authority or of a court of law on a tax question for which the treaty is considered to or should be considered.”<sup>277</sup>

In other words, the discharge of income in according to a DTA constitutes application, as does the decision that the DTA is not applicable for a particular income or capital.<sup>278</sup> According to Avery Jones<sup>279</sup> who has a different view about it, there is an “application” of a DTA when a contracting State uses the provisions of a DTA to get a different tax outcome from that under the internal law. The source State applies the DTA by exempting the income as categorized under its internal law. The residence State must then provide double taxation relief under credit or exemption methods for the tax component “in accordance with the provisions of this Convention, may be taxed in the source State”.<sup>280</sup>

If the source State used the internal law definition of a particular income, that allows it to tax the income under the DTA, then the residence State has two possibilities. The residence State must first check whether the source State has taxed the income in accordance with the DTA. This involves a process whereby the residence State simply reads the DTA and ‘not applying

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<sup>274</sup>*Ibid.*

<sup>275</sup>*Ibid.*

<sup>276</sup>*Ibid* p 211, marginal note 65.

<sup>277</sup>*Ibid.*

<sup>278</sup>*Ibid.*

<sup>279</sup> Avery Jones, J. F. (1993). Article 3 (2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, International Bureau of Fiscal Documentation, European Taxation, No. 8, Volume: 33, p 254.

<sup>280</sup>*Ibid* p 255.

it.<sup>281</sup> The residence State may only satisfy itself that the source State has taxed the income in accordance with the provisions of the OECD MTC.<sup>282</sup>

Secondly, the residence State will do something by providing double taxation relief (credit or exemption methods).<sup>283</sup> The residence State does not apply the DTA because the classification of income is not relevant to this phase. As long as the source State tax in accordance with the DTA the result of the second possibility will be the same whatever the classification of the income.<sup>284</sup> This thesis is of the view that the approach by Avery Jones should be followed.

### 3.9.2 Internal law reference

Another problem and contentious issue of interpretation in connection with Article 3 (2) of the OECD MTC is which contracting State internal statutory law definition is to be applied. The source and residence States will often apply the DTA differently because definitions under their internal statutory tax law may differ.

The *Boulez v Commissioner*<sup>285</sup> case is a good example of internal domestic law definition conflict. In this case a non-resident foreigner of the United States of America ('USA') and a resident of Germany, contracted with a recording company to make recordings of orchestral works, some of them recorded in the USA. Under the 1954 U.S – Germany DTA, income from personal services performed in the USA was taxable in the USA, but royalties derived by a natural person resident in Germany were exempt from USA tax. The USA claimed that the compensation paid to the taxpayer was compensation for personal services, while Germany was of the opinion that the compensation presented exempted royalties. This dispute was referred to the competent authorities, but they were unable to reach consensus. The Tax Court held the compensation was for personal services and accordingly, not exempt

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<sup>281</sup> *Ibid* p 255.

<sup>282</sup> OECD MTC. (2010). Condensed Version, Paris: Article 23 A and B.

<sup>283</sup> Avery Jones, J. F. (1993). Article 3 (2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, International Bureau of Fiscal Documentation, European Taxation, No. 8, Volume: 33, p 255.

<sup>284</sup> *Ibid* p 255.

<sup>285</sup> 83 T.C. 584 (1984).

under the USA – Germany DTA. The Germany tax authorities disagreed, and also taxed the income without granting double tax relief under the DTA.<sup>286</sup>

If contracting States are to apply different distributive rules on the same income, double taxation or double non – taxation may arise.<sup>287</sup> *Avery Jones*<sup>288</sup> argued that the residence State should follow the internal law definition of the source State if the two contracting States differ. *Vogel* differed and reasoned that the residence State internal law definition must be applied to determine whether the source State internal law definition is in accord with the DTA.<sup>289</sup>

The source State internal law definition has been endorsed in the 2000 Commentaries,<sup>290</sup> following the 1999 OECD Partnership Report.<sup>291</sup> The changes have clarified that the residence State should accept the source State description of income and give double taxation relief under Article 23 (using either exemption or credit methods), even if the residence State would have classified the income differently due to differences in the internal law of the contracting States.<sup>292</sup> The residence State may only verify whether the source State has taxed the income in accordance with the provisions of the DTA.<sup>293</sup>

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<sup>286</sup>Qureshi, A. H. (1994). *The Public International Law of Taxation: Text, Cases & Materials*, p 141.

<sup>287</sup>Rohatgi, R. (2005). *Basic International Taxation*, Volume: 1, p 53.

<sup>288</sup>Avery Jones, J. F. (1993). Article 3 (2) of the OECD Model Convention and the Commentary to It: Treaty Interpretation, International Bureau of Fiscal Documentation, *European Taxation*, No. 8, Volume: 33, p 254; OECD MTC. (2010). Condensed Version, Paris: Article 23 A and B.

<sup>289</sup>Vogel, K. (1997). *Double Taxation Conventions* Kluwer Law International, p 212 -213, marginal note 66.

<sup>290</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 23 A and 23B, paragraphs 32.1 - 32.7.

<sup>291</sup>Rohatgi, R. (2005). *Basic International Taxation*, Volume: 1, p 53.

<sup>292</sup>Avery Jones, J. F. (2001). The “One True Meaning” of a Tax Treaty, *Bulletin – Tax Treaty Monitor*, International Bureau of Fiscal Documentation, *European Taxation*, No. 6, Volume: 55, p 220; OECD MTC. (2010). Condensed Version, Paris: Article 23 A and B.

<sup>293</sup>*Ibid* p 53 -54.

### 3.9.3 Which internal law meaning

The earlier version of Article 3 (2) of the OECD MTC is unclear as to whether references to internal law covers only internal tax law or also other non-tax internal laws. The 1995 version of Article 3 (2) of the OECD MTC<sup>294</sup> refers to:

“the law of that State for the purposes of the taxes to which the convention applies, any meaning the applicable tax laws prevailing over a meaning given to the term under other laws of that State”.

Therefore, the meaning in any other internal law than tax law may be used to interpret undefined tax DTA terms; but a tax law meaning takes precedence over the other internal law meanings.

### 3.9.4 Unless the context otherwise requires

### 3.9.5 Context

The simple words of Article 3 (2) make it clear that the internal law meaning of undefined DTA terms should apply “unless the context otherwise requires”.<sup>295</sup> This raises question about what is meant by “context”. The term “context” is not defined in the OECD MTC. The OECD MTC Commentary states that “context” is determined by the intentions of the contracting States when signing the DTA as well as the meaning given to the term in question in the internal laws of the other Contracting State”.<sup>296</sup> Avery Jones *et al*<sup>297</sup> mentioned that “context” in Article 3 (2) could include “all of the items which may have recourse, in interpretation treaties generally”. The word “requires” is a word of some force.<sup>298</sup> The use of “requires” indicated that Article 3 (2) is different from the interpretation rules contained in the VCLT.

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<sup>294</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on article 3 (2), p 82:13.1

<sup>295</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 33C – 20.

<sup>296</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 3 (2), p81:12.

<sup>297</sup>Avery Jones, J.F., Berg, C.J., Depret, HR., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A. (1984). The Interpretations of Tax Treaties with Particular Reference Article 3 (2) of the OECD Model. *British Tax Review*, No. 2, p 104.

<sup>298</sup>*Ibid* p 108.

As earlier mentioned, the word “context” in Article 31 (2) of the VCLT contains the text of the DTA and its preamble or annex to the DTA. It also includes any agreement reached between the contracting States and any instrument accepted by the contracting States relating to the DTA.<sup>299</sup> This seems to be a too narrow view of context.<sup>300</sup> The term “context” stated in Article 3 (2) of the OECD MTC DTA is different from the term “context” in Article 31 (2) of the VCLT. In order to determine the domestic meaning of DTA term for the purpose of Article 3 (2), the “context” in Article 3 (2) should be interpreted as broad as possible to include anything that can be taken into account in interpreting the DTA.<sup>301</sup>

### **3.9.6 When does the Context require otherwise**

Does the term ‘context’ requires ‘otherwise’ than the recourse to the internal law is a matter of degree, Vogel is of the opinion that:<sup>302</sup>

“...not every apparently convincing interpretation from the context should give rise to a divergence from the rule of Article 3(2), but only those based on relatively strong arguments”.

Therefore, Article 3 (2) of the OECD MTC uses internal law unless the context otherwise requires. Whether the context is adequate and acceptable to overcome another interpretation that is acceptably persuasive to reverse the domestic meaning of the DTA term is a matter that can be decided only on its facts in relation to each individual case.<sup>303</sup>

### **3.9.7 Static versus Ambulatory interpretation of article 3 (2) of the OECD MTC**

Another interpretational issue caused by Article 3 (2) of the OECD MTC is whether the contracting States can apply the internal law meaning of the undefined term when the DTA

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<sup>299</sup>Vienna Convention on the Law of Treaties. (1969). Article 31 (2).

<sup>300</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 33 C – 20.

<sup>301</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 214 -215, marginal note 72; Avery Jones, J.F., Berg, C.J., Depret, HR., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A. (1984). The Interpretations of Tax Treaties with Particular Reference Article 3 (2) of the OECD Model. British Tax Review, No. 2, p 108.

<sup>302</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 214, marginal note 71.

<sup>303</sup>Avery Jones, J.F., Berg, C.J., Depret, HR., Ellis, M.J., Fontaneau, P., Lenz, R., Miyatake, T., Roberts, S.I., Sandels, S., Strobl, J., Ward, D.A. (1984). The Interpretations of Tax Treaties with Particular Reference Article 3 (2) of the OECD Model. British Tax Review, No. 2, p 108.

come into force (static interpretation) or the meaning when the DTA is applied (ambulatory interpretation). The ambulatory interpretation method of undefined treaty is contained in the OECD MTC Commentary.<sup>304</sup> The words “at any time” and “at that time” in the text of Article 3 (2) of the OECD MTC makes the OECD position clear in the text of the OECD MTC.<sup>305</sup> The ambulatory method of interpretation is used for effectiveness. Reference to outdated concepts should be avoided and a DTA should over time be applied in a convenient and practical manner.<sup>306</sup> This method of interpretation of DTAs can also be directed by statute. For an instance, section 3 of the Canadian Income Tax Conventions Interpretations Act 1985 provides that, except to the extent that the context otherwise requires, an undefined term in a DTA has the meaning applicable for the purpose of the Canadian Income Tax Act (1985) as amended from time to time (the ambulatory meaning).<sup>307</sup> It is also endorsed by the OECD MTC Commentary.<sup>308</sup>

### **3.10 The relationship between Article 3 (2) and the interpretation rules in the VCLT**

The exact purpose of Article 3 (2) and its relationship within the rules of interpretation of the VCLT is uncertain.<sup>309</sup> The OECD MTC Commentary does not clarify the VCLT relationship to Article 3 (2).<sup>310</sup> As mentioned earlier, Articles 31 to 33 of the VCLT and Article 3 (2) of the OECD MTC present rules of interpretation for OECD MTC DTAs. However, there is a view that Article 3 (2) of the OECD MTC is *lex specialis* in relation to Articles 31 and 32 of the VCLT.<sup>311</sup> The reasoning behind this is, while the VCLT is loosely led towards the

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<sup>304</sup>OECD MTC. (2010). Condensed Version, Paris: Commentary on Article 3 (2), p 81:11.

<sup>305</sup>*Ibid.*

<sup>306</sup>*Ibid* p 81, 82:13.

<sup>307</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 51.

<sup>308</sup>OECD MTC. (2010). Condensed Version, Paris, Introduction, p 15:35; OECD MTC.(2010).Condensed Version, Paris: Commentary on Article 3 (2), p 81: 11.

<sup>309</sup>Van der Bruggen, E. (2003). Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3 (2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties, International Bureau of Fiscal Documentation, European Taxation, No.5, Volume: 43, p 142.

<sup>310</sup>*Ibid.*

<sup>311</sup>Van der Bruggen, E. (2003). Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3 (2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention

interpretation of international treaties in general. Article 3 (2) refers specifically to OECD MTC DTA. Because of this speciality, Article 3 (2) prevails over the general interpretation rules in VCLT.<sup>312</sup> However, Rohatgi is of the view that the rules of interpretation of the VCLT take precedence over Article 3(2). This is because Article 3 (2) is part of a DTA and its meaning should enable the DTA provisions to be effective.<sup>313</sup> The object and purpose of the DTA, which is to avoid double taxation and to prevent tax evasion, should not be defeated by meaning of the words in Article 3 (2). Hence, the words in Article 3(2) should be performed in good faith.<sup>314</sup>

### 3.11 Reference to Other DTAs Entered into by the States (Parallel Treaties)

Another interpretation issue is whether provisions of one DTA can be derived from the fact that a similar provision is contained in another DTA. In other words, can a DTA also recourse to other DTA entered into by the contracting States ('parallel treaties').

Baker remarks as follows:

“There is no reason why parallel treaties should not be referred to, but their values as aids to interpretation will generally be low”.<sup>315</sup>

Two contracting States may make use of parallel treaties entered into in order to interpret a DTA terms, but extreme caution where the matter is concerned is recommended.<sup>316</sup> A DTA becomes part of the internal statutory law of the contracting State after their conclusions and when enacted into the domestic law of the particular contracting State. Every DTA is the product of its own negotiations, each of them with its own particulars and characteristics.<sup>317</sup>

The question of parallel treaties will only come up where a term is defined in only one DTA and not in the others DTAs. The prevention of double taxation and tax evasion is a

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on the Law of Treaties, International Bureau of Fiscal Documentation, European Taxation, No.5, Volume: 43, p 142; Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 209, marginal note 61.

<sup>312</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 208 – 209, marginal note 61.

<sup>313</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 48.

<sup>314</sup>*Ibid.*

<sup>315</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p39 C – 33.

<sup>316</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 50, marginal note 86.

<sup>317</sup>*Ibid* p 50, marginal note 85.



fundamental feature of DTAs. This does not prevent the use of parallel treaties in interpreting terms that are not defined in the DTA. It is therefore possible to use parallel treaties for the interpretation of DTAs, but with extreme caution.

### 3.12 Common Interpretation: Reference to decisions of Foreign Courts

In interpreting DTAs, an interpretation that must be pursued is the one which will be satisfactory to both contracting States. Tax authorities and courts in contracting States must apply interpretative decisions of authorities in one contracting State on a similar DTA provision.<sup>318</sup> This is called the concept of “common interpretation”.<sup>319</sup> By applying the ‘principle of common interpretation’, problems of different approaches of interpretation might be resolved. According to this principle, courts of one contracting State should look at decisions made by courts of the other contracting State when confronted with problems of DTAs interpretation and they test whether their interpretations can be transferred.

If they are reasonable and their application may lead to the avoidance of double taxation or tax prevention, they should at least be considered and any deviation from them should be explained explicitly and convincingly.<sup>320</sup> The mutual agreement procedure is intended to facilitate such an approach.<sup>321</sup>

The OECD MTC Commentary has appealed for a constant interpretation of OECD MTC DTAs by stating that:

“... harmonization of these conventions in accordance with uniform principles, definitions, rules , and methods, and agreement on a common interpretation, become increasing desirable.”<sup>322</sup>

Nowhere is any reference in the VCLT or any article in the OECD MTC to the concept of ‘common interpretation’. Even Article 3 (2) of the OECD MTC does not answer this issue.<sup>323</sup>

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<sup>318</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 39 C 28.

<sup>319</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 39, marginal note 74.

<sup>320</sup>*Ibid.*

<sup>321</sup>OECD MTC. (2010). Condensed Version, Paris: Article 25.

<sup>322</sup>*Ibid* Introduction, p 7- 8: 5.

<sup>323</sup>Baker, P. (1994). Double Taxation Conventions and International Tax Law, p 39 C 28.



Baker<sup>324</sup> considers a common interpretation between the contracting States to be necessary, quoting the precedents of Australia and other States that are in support of resorting to foreign decisions as a means of obtaining consensus where interpretation of DTAs is involved.

Interpretation judgments on DTA by the courts or authorities in the other contracting States or third States are not mandatory, but may be applied. They are persuasive, but not binding. However, these foreign judicial decisions may provide valuable interpretation sources.<sup>325</sup>

Vogel also notes the importance of a consistent interpretation of DTA by the contracting States involved.<sup>326</sup> He refers to a number of foreign juridical decisions in support of the common interpretation. According to Baker the common interpretation method does not mean that foreign juridical decisions must be accepted without being reviewed, whether this is a decision by a court of the other contracting State or by a third State.<sup>327</sup> The provisions of Article 33 (4) of VCLT regarding the interpretation of DTA negotiated in two or more languages are also referring to the principle of common interpretation.<sup>328</sup>

In domestic law of the contracting State, common interpretation is a rule of interpretation. It is expected from judges to examine foreign juridical decisions and evaluate their decisions. A judge must choose the interpretation most likely to find mutual approval by courts, rather than following a personal view of interpretation. The same will apply with regard to other contracting States courts.<sup>329</sup>

To get information is a problem which arises with the common interpretation. If foreign juridical decisions are in a foreign language with regard to the DTA, a judge has to translate them. The problem of inability to read foreign materials may be a limitation to common interpretation.<sup>330</sup>

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<sup>324</sup>*Ibid* p 39 C 28 – C30.

<sup>325</sup>Rohatgi, R. (2005). Basic International Taxation, Volume: 1, p 59.

<sup>326</sup>Vogel, K. (1997). Double Taxation Conventions Kluwer Law International, p 39, marginal note 74.

<sup>327</sup>*Ibid* p 41, marginal note 76.

<sup>328</sup>*Ibid* p 41, marginal note 75a.

<sup>329</sup>*Ibid* p 42, marginal note 77.

<sup>330</sup>*Ibid*.

### 3.13 Concluding remarks

In this chapter, the legal framework by which DTAs work and the role of the VCLT and other international norms of aids used in interpreting of DTAs is examined. It has been seen that as DTAs are one form of many international agreements, the VCLT, is the foundation authority for the interpretation of DTAs.

The rules of interpretation in VCLT can be found in Articles 31 to 33 of the Convention. Article 32 of the Convention provides recourse to supplementary means of interpretation, which in turn should confirm to the broad principles of Article 31 as summarized above. According to Article 32 of VCLT, the ‘supplementary means of interpretation’ include the preparatory work of the treaty and the circumstances of its conclusion. The word ‘include’ indicates that the rule is not exhaustive and there may be other supplementary means of interpretation. One such means is provided for by the commentaries attached to the OECD MTC. To this extent, the provisions of South African DTAs are similar to OECD MTC and the OECD commentaries may become relevant to interpretation of South African DTAs. The importance of the OECD MTC commentaries is that they provide a source from which different contracting States’ courts can seek a common interpretation.

Most South African DTAs contain a provision to the effect that, in the application of the provisions of the DTA, any term not otherwise defined will have the meaning which it has under the laws of that state relating to the taxes which are the subject of the DTA. However, there is disagreement on whether Article 3 (2) of the OECD MTC is *lex specialis* in relation to Articles 31 and 32 of the VCLT.

Parallel treaties are relevant for reasons of legitimacy. Therefore their impact should depend upon the influence of their fundamental perceptive. Common interpretation is cherished because it promotes reciprocity and reduces the likelihood of both double taxation and double exemption. Therefore, it must be emphasized that common interpretation should confer significant weight as an interpretive objective.

## 4 CHAPTER 4: SOUTH AFRICAN APPROACH TO INTERPRETATION OF DTAs AS INTERNATIONAL AGREEMENTS UNDER THE SOUTH AFRICAN CONSTITUTION OF 1996

### 4.1 Introduction

This chapter deals with the application of international law of taxation in South Africa in the period after the adoption of the 1996 Constitution ('the Constitution').<sup>331</sup> This chapter is however limited to two South African norms of international law in relation to taxation namely; treaties and customary international law.

The five legal sources of international law are international treaties,<sup>332</sup> which are written agreements between states or between states and international organizations operating within the field of international law;<sup>333</sup> international custom (customary international law) which comprises of rules that are based on settled, widespread state practice usually manifested over time (*usus*), coupled with evidence of an intention to be bound by the practice as a legal obligation on the part of states (*opinion juris*);<sup>334</sup> general principles of law recognized by states which are common principles of law found in domestic legal systems to the extent of which they are appropriate for application to international relations, in order to fill a gap in international law;<sup>335</sup> judicial decisions, on which courts usually place heavy dependence<sup>336</sup> and teachings of the most highly qualified publicists (commentators and well-known authors) in various States.<sup>337</sup>

International law is a mixture of treaties and customs that regulate the conduct of states, and between States and international organizations.<sup>338</sup> In South Africa<sup>339</sup> the two main sources of

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<sup>331</sup>Constitution of the Republic of South Africa, 1996.

<sup>332</sup>Brownlie, I. (2003). Principles of Public International Law, p 4 – 5.

<sup>333</sup>*Ibid* p 12 – 15.

<sup>334</sup>*Ibid* p 6 -12.

<sup>335</sup>*Ibid* p 5- 18.

<sup>336</sup>*Ibid* p 19 – 23.

<sup>337</sup>*Ibid* p 23 – 24.

<sup>338</sup>*Ibid*.

<sup>339</sup>See sections 231, 232 and 233 of the Constitution of the Republic of South Africa, 1996.

international law are in treaties (agreements between South African government and other contracting States) and customary international law, which codified the VCLT.<sup>340</sup>

A treaty (or convention, memorandum or international agreement, charter, or covenant) is a written agreement between States or States and international organizations governed by international law, which outlines and modifies their common obligations towards their own citizens or between each other as States.<sup>341</sup> The VCLT contain the rules that governed treaties.<sup>342</sup> Treaties may be either bilateral (between two parties), or multilateral (between more than two parties). A treaty system is based on the agreement of contracting States signing and ratifying the treaty.<sup>343</sup>

Customary international law is an international custom (the common law of the international community) and occupies a major role in the global legal system.<sup>344</sup> Customary international law is made up of elements of long-term exercise (several years) and the belief that this exercise is lawful (*opinion iuris*). In the *North Sea Continental Shelf Cases* judgment of the International Court of Justice ('ICJ')<sup>345</sup> the requirements for the establishments of a custom were pronounced as follows:

“Not only must the acts concerned amount to a settled practice but must also be such or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e. the existence of a subjective element, is implicit in the very notion of the *opinio juris sive necessitatis*. The States concerned must therefore feel that they are conforming to what amounts to a legal obligation. The frequency or even habitual character of the acts is not in itself enough. There are many international acts, e.g in the fields of ceremonial and protocol, which are performed almost invariably, but

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<sup>340</sup>Dugard, J. (2011). International Law A South African Perspective, p 24.

<sup>341</sup>Vienna Convention on the Law of Treaties.(1969). Article 2 (1) (a).

<sup>342</sup>Dugard, J. (2011). International Law A South African Perspective, p 25.

<sup>343</sup>*Ibid*.

<sup>344</sup>*Ibid* p 26.

<sup>345</sup>North Sea Continental Shelf (Federal Republic of Germany v Denmark; Federal Republic of Germany v Netherlands). (1969). ICJ Reports 3, p 44, par 77.

which are motivated only by considerations of courtesy, convenience or tradition, and not by any sense of legal duty.”

It is widely agreed that for international custom to exist there has to be settled practice (*usus*)<sup>346</sup> and this practice has to be accompanied by a sense of legal duty to be bound (*Opinio juris sive necessitatis*).<sup>347</sup> Whether international custom qualify as customary international law is a question to be decided by the South Africa courts through the application of the international criteria of *usus* and *opinio juris*.<sup>348</sup>

There is a general recognition that customary international law enjoys a status at least equal to that of domestic statutes and common law and will be treated accordingly by South African courts.<sup>349</sup> The 1996 Constitution<sup>350</sup> set the basis for the determining of international law in South Africa. The interpretational role of international law is obvious from four provisions in the 1996 Constitution,<sup>351</sup> the interpretation clause of the Bill of Rights,<sup>352</sup> the status of international agreements,<sup>353</sup> customary international law<sup>354</sup> and the application of international law.

## **4.2 The application of International Law in South Africa**

### **4.3 Treaties in South African Law**

Before the 1993 interim Constitution<sup>355</sup> South Africa followed the Westminster dualist approach to treaties<sup>356</sup> which could only be applied by the courts if they had been

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<sup>346</sup>Dugard, J. (2011). International Law A South African Perspective, p 26.

<sup>347</sup>*Ibid* p 29.

<sup>348</sup>*S v Petane* 1988 (3) 51 (C) SA 57F – 58F.

<sup>349</sup>Sections 231 (4) and 232 of Constitution of the Republic of South Africa, 1996.

<sup>350</sup>*Ibid*.

<sup>351</sup> *Ibid*.

<sup>352</sup>*Ibid* Section 39.

<sup>353</sup>*Ibid* Section 231.

<sup>354</sup>*Ibid* Section 232.

<sup>355</sup>Constitution of the Republic of South Africa, Act 200 of 1993.

<sup>356</sup>*CSARS v Van Kets* 2012 (2) All SA WCC 416 par 13D.

incorporated through national legislation (parliamentary intervention).<sup>357</sup> The executive negotiated, signed, ratified treaties and also acceded treaties.<sup>358</sup> Thus, treaty-making was not a legislative, but an executive act.<sup>359</sup>

The Appellant Division of the South African Supreme Court in *American World Airways Inc v SA Fire and Accident Insurance Co. Ltd*, Steyn CJ<sup>360</sup> sanctioned this dualist approach regarding domestic application of treaty obligations and expressed itself as follows:

“It is common cause, and trite law I think, that in this country the conclusion of a treaty, convention or agreement by the South African government with any other Government is an executive and not a legislative act. As a general rule, the provisions of an international instrument so concluded are not embodied in our municipal law except by legislative process. The Universal Postal Convention and the Bilateral Air Transport Agreement are no exceptions”.<sup>361</sup>

According to this *dictum* treaty provisions could not be considered as part of domestic law, because the legislature was excluded from the original conclusion of a treaty.<sup>362</sup>

This was also sanctioned in *Azanian Peoples Organization ('Azapo') and Others v President of the South Africa and Others*<sup>363</sup> where Mohamed DP held that:

“International conventions and treaties do not become part of the municipal law of our country, enforceable at the instance of private individuals in our courts, until and unless they are incorporated into the municipal law by legislative enactment.”<sup>364</sup>

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<sup>357</sup>Dugard, J. (2011). *International Law A South African Perspective*, p 53.

<sup>358</sup>*Ibid.*

<sup>359</sup>*Ibid.*

<sup>360</sup>1965 (3) SA (A) 150.

<sup>361</sup>1965 3 SA 161C - D (A), Dugard, J. (2011). *International Law A South African Perspective*, p 48.

<sup>362</sup>Olivier, M, E. (2002). Exploring the *doctrine* of self-execution as enforcement mechanism of international obligations, *South African Yearbook of International Law*, Volume: 27, p 114.

<sup>363</sup>1996 (4) SA 671 (CC).

<sup>364</sup>1996 (4) SA 671 (CC) 688 par 26B -C.

The common status and consequence of international agreements in South Africa is provided for in section 231 of the Constitution. Section 231 of the Constitution governs international agreements and provides that:

- “(1) The negotiating and signing of all international agreements is the responsibility of the national executive.
- (2) An international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).
- (3) 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
- (4) Any international agreement becomes law in the Republic when it is enacted into law by national legislation; but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.
- (5) The Republic is bound by international agreements which were binding on the Republic when this Constitution took effect.”

This section makes it clear that South Africa continues to adopt the Westminster dualist approach with regard to the application of international agreements.<sup>365</sup> The same section goes further to provide that ‘a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament’.<sup>366</sup> According to this section there is a balance of sharing of power in South Africa with regard to the application of international agreements.<sup>367</sup> The responsibility of negotiating and signing international agreements is vest in executive branch of government

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<sup>365</sup>Section 231(4) of the Constitution of the Republic of South Africa, 1996; *Glenister v President of the Republic of South Africa* 2011 (3) SA 374 par 90C -D.

<sup>366</sup>Section 231(4) of the Constitution of the Republic of South Africa, 1996.

<sup>367</sup>*Glenister v President of RSA* 2011 (3) SA 374 par 89A -B.

while the ratification of such treaties should receive prior approval of Parliament.<sup>368</sup> In South Africa an international agreement becomes law only when it is incorporation into law by national statute.<sup>369</sup>

#### 4.4 International agreement

Section 231 (1) which governs the conclusion of international agreements by the State, specifically refers to a vague term ‘international agreements, but does not define or prefer the more customary term treaty or conventions.<sup>370</sup> The 1996 Constitution preferred the term international agreement as being broad and inclusive rather than referring to specific kinds of agreements such as treaties or conventions.<sup>371</sup> In *Harksen v President of the Republic of South Africa* Goldstone J<sup>372</sup> held that:

“Although the judicial determination of the existence of an international agreement may require the consideration of a number of complex issues, the decisive factor is said to be whether “the instrument is intended to create international legal rights and obligations between the parties”.<sup>373</sup>

Therefore, an international agreement does not have any particular technical meaning, and should be rather given a wider interpretation and understood as a universal term incorporating all kinds of agreements (treaties, conventions, protocols and exchange of notes).<sup>374</sup> The term ‘international agreement’ can therefore be defined as a written agreement between

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<sup>368</sup>Dugard, J. (2011). *International Law A South African Perspective*, p 54; Section 231 (1), (2) of the Constitution of the Republic of South Africa, 1996; *Glenister v President of RSA* 2011 (3) SA 374 par 89 A - B.

<sup>369</sup>*Glenister v President of the Republic of South Africa* 2011 (3) SA 374 par 90 C -D.

<sup>370</sup>Botha, N. (2000). *Treaty making in South Africa: A reassessment*, *South African Yearbook of International Law*, Volume: 25, p 71.

<sup>371</sup>Olivier, M, E. (1997). *Informal agreements under the 1996 constitution*, *South African Yearbook of International Law*, Volume: 22, p 65.

<sup>372</sup>2000 (2) SA 825 (CC).

<sup>373</sup>2000 (2) SA 825 (CC) 834 p 21 B – C.

<sup>374</sup>Botha, N. (2000). *Treaty making in South Africa: A reassessment*, *South African Yearbook of International Law*, Volume: 25, p 71.



contracting States governed by international law in terms of the VCLT.<sup>375</sup> It would also appear that the term ‘international agreement’ is much wider than what is traditionally understood under the term treaty.<sup>376</sup> The ability of the contracting States that are parties to the international agreement rather than the subject matter of the international agreement determined the universal character of the international agreement.<sup>377</sup>

#### **4.5 International Agreements requiring Parliamentary and Executive Approval**

Section 231 of the 1996 Constitution also makes a distinction between those treaties that requiring parliamentary approval<sup>378</sup> and the technical, administrative or executive agreements,<sup>379</sup> which can be concluded by the national executive alone.

Section 231(2) provides that Parliament (that is both the National Assembly and the National Council of Provinces sitting separately) decides on the ratification of or accession to agreements which are not of a technical, administrative or executive nature.<sup>380</sup> The role of internal significance of treaties is now in the hands of the legislature rather than the executive as before the interim Constitution.<sup>381</sup> While the executive branch of government is responsible for the negotiating and signing international agreements, the ratification of such agreements should receive the prior approval of Parliament.<sup>382</sup> Most international agreements that do required parliamentary approval are usually multilateral agreements that have financial implications that require an additional budgetary allocation from Parliament. They

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<sup>375</sup>Vienna Convention on the Law of Treaties. (1969). Article 2 (1).

<sup>376</sup>Olivier, M, E. (1997). Informal agreements under the 1996 constitution, South African Yearbook of International Law, Volume: 22, p 65.

<sup>377</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 73.

<sup>378</sup>Section 231 (2) of the Constitution of the Republic of South Africa, 1996.

<sup>379</sup>Section 231 (3) of the Constitution of the Republic of South Africa, 1996

<sup>380</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 79.

<sup>381</sup>Act 200 of 1993.

<sup>382</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 80.

have legislative or domestic implications e.g. require new legislation or legislative amendments.<sup>383</sup>

The methods for approving international agreements that required parliamentary are laid down in the rules of procedures of the National Assembly ('NA').<sup>384</sup> The cabinet<sup>385</sup> is required to submit a copy of the international agreement together with an advisory *memorandum* to the NA.<sup>386</sup> The Speaker must place the international agreement and advisory *memorandum* to the international agreement on the Assembly's table, and refer them to one of the NAs committees that is responsible for the matter, or any other committee that the NA might decide upon, for the purpose of assessment and reporting.<sup>387</sup> This Committee must inspect the international agreement in order to endorse authorization or refusal.<sup>388</sup> The Committee will then present a report to the NA, with a recommendation whether to accept the international agreement, or reject it.<sup>389</sup> This report will be instructed to a motion for the agenda for the adoption of a decision by the NA.<sup>390</sup>

#### **4.6 International Agreements of technical, administrative or executive nature or an agreement which does not require either ratification or accession**

Section 231(3) of the 1996 Constitution provides an exception in relation to international agreements of a technical, administrative or executive nature.<sup>391</sup> It provides that such agreements or an agreement which does not require either ratification or accession binds South Africa without approval by the both houses of Parliament, but must be tabled in the Assembly and the Council within a reasonable time.<sup>392</sup> For the adoption of international

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<sup>383</sup>*Ibid* p 81.

<sup>384</sup>Rules 306-308 of the National Assembly. June 2011.

<sup>385</sup> Section 91(1) of the Constitution of the Republic of South Africa, 1996 provides that “the Cabinet consists of the President, as head of the Cabinet, a Deputy President and Ministers”).

<sup>386</sup>Rule 306 of the National Assembly. June 2011.

<sup>387</sup>*Ibid* Rule 307 (1).

<sup>388</sup>*Ibid* Rule 307 (2).

<sup>389</sup>*Ibid* Rule 307 (3).

<sup>390</sup>*Ibid* Rule 307 (4).

<sup>391</sup>Constitution of the Republic of South Africa, 1996.

<sup>392</sup>*Ibid*.

agreements which can be concluded by the national executive alone<sup>393</sup> in the NA the Speaker must convey the international agreement for *informare* to the portfolio committee under which authority the subject of the international agreement falls.<sup>394</sup> If not feasible then the Speaker must refer by declaration of the NA to any other NA committee.<sup>395</sup>

It appears from section 231 (3) that there are two categories of agreements that do not need parliamentary approval.<sup>396</sup> The first category is technical, administrative and executive agreements.<sup>397</sup> Executive agreements in this instance do not refer to self-executing agreements as mentioned in section 231 (4). It is suggested that the words ‘technical, administrative or executive’ should be used interchangeably as they are not defined by the Constitution or given any further interpretation.<sup>398</sup> Technical, administrative and executive agreements are those agreements which do not fall within the ambit of section 231 (2) of the Constitution.<sup>399</sup> They have no parliamentary or have no extra-budgetary financial implications and they do not have legislative implications.<sup>400</sup> They are routine agreements and flow from the everyday activities of government departments.<sup>401</sup>

The second category refers to international agreements that do not require ‘ratification of accession’. Ratification here bears two meanings. First, there is what is called primary or international ratification and applies to those agreements which apart from signature also

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<sup>393</sup>*Ibid* section 131 (3).

<sup>394</sup>Rule 308 (a) of the National Assembly (June 2011).

<sup>395</sup>*Ibid* Rule 308 (b).

<sup>396</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 75.

<sup>397</sup>*Ibid* p 76.

<sup>398</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 76.

<sup>399</sup>Constitution of the Republic of South Africa, 1996; Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 76.

<sup>400</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 76.

<sup>401</sup>*Ibid* p 77.

require ratification to bring them into force internationally.<sup>402</sup> This does not, however, give the treaty municipal application. Secondly in terms of constitutional ratification, the treaty is given municipal application.<sup>403</sup>

International law does not set down any exact requirements for the ratification of treaties. The VCLT defined the terms ‘ratification’, ‘acceptance’, ‘approval’ and ‘accession’ together in the definitions article to mean “the international plane its consent to be bound by a treaty”.<sup>404</sup> Article 11 of the VCLT clarified the form of ratification as one of the means by which consent to be bound may be expressed.<sup>405</sup>

In conclusion the distinction between agreements that requiring parliamentary approval and those requiring executive approval turns on the definition of the terms “technical administrative or executive nature” as provided by section 231 (3).<sup>406</sup>

#### **4.7 The doctrine of self-executing treaties in South African Law**

The proviso to section 231(4) of the South African Constitution<sup>407</sup> introduces the concept of self- executing treaties into South Africa law as follows:

“...but a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament”.

Section 231 (4) of the Constitution provides for two ways in terms of which international law can be applied in South Africa law.<sup>408</sup> The first requires that treaties become part of South

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<sup>402</sup>Botha, N. (1995). Incorporation of treaties under the Interim Constitution: a pattern emerges. South Africa Yearbook of International Law, Volume: 20, p 197.

<sup>403</sup>*Ibid* p 197.

<sup>404</sup>Vienna Convention on the Law of Treaties. (1969). Article 31 (2).

<sup>405</sup>Botha, N. (1995). Incorporation of treaties under the Interim Constitution: a pattern emerges. South Africa Yearbook of International Law, Volume: 20, p 197 – 198.

<sup>406</sup>Botha, N. (2000). Treaty making in South Africa: A reassessment, South African Yearbook of International Law, Volume: 25, p 77.

<sup>407</sup>Constitution of the Republic of South Africa, 1996.

<sup>408</sup>*Ibid*.

Africa law only when enacted in domestic legislation<sup>409</sup> and the second alternative is that self-executing provision of an agreement is law in South Africa without statutory incorporation, ‘unless inconsistent with the Constitution or an Act of Parliament’.<sup>410</sup>

The *doctrine* of self-executing treaties, which is indigenous largely to United States law, is a new concept to South African law.<sup>411</sup> A self – execution treaty is treaties that become part of South African domestic law and enforceable by courts without any statutory incorporation.<sup>412</sup>

In the *President of the Republic of South Africa v Quagliani; President of the Republic of South Africa A v Van Rooyen; Brown v President of the RSA case no 959/2004 TPD 6 March 2007 (unreported) and Goodwin v Director-General of Justice and Constitutional Development*<sup>413</sup> cases which were held together on appeal in the Constitutional Court Sachs J held that the Extradition Act provides for a “framework for giving domestic effect to the content of those treaties” and that it was unnecessary to determine whether such a treaty was self-executing or not.<sup>414</sup>

The court thus refused to provide any clarified on the meaning of self – executing treaties. Dugard<sup>415</sup> in this regards submits that the meaning given to self – executing treaties in section 231 (4) must be define by South Africa courts. The South Africa courts must not pretend that the proviso to section 231 (4) does not exist or ague that treaties can be incorporated into South Africa domestic law by means other than national legislation. The position of

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<sup>409</sup>This affirm again the classical dualist approach prior 1993 Constitution and was endorsed in *Pan American Airways Incorporated v SA Fire and Accident Insurance* 1965 3 SA 161C - D (A).

<sup>410</sup>Olivier. M, E. (2002). Exploring the doctrine of self-execution as enforcement mechanism of international obligations, *South African Yearbook of International Law*, Volume: 27, p 115.

<sup>411</sup>Ngolele. E, M. (2006). The content of the doctrine of self-execution and its limited effect in South Africa *South Africa Yearbook of International Law*, Volume 31, p 141.

<sup>412</sup>Dugard, J. (2011). *International Law A South African Perspective* 4ed p 56, See also in general pages 56 -57 for the different views expressed by South African legal academics on self – executing treaties.

<sup>413</sup>2009 (4) BCLR 345 (CC).

<sup>414</sup>2009 (4) BCLR 359 (CC) A.

<sup>415</sup>Dugard, J. (2011). *International Law A South African Perspective*, p 59.

international agreements in South African was considered in *Glenister v President of the Republic of South Africa and Others*<sup>416</sup> where Ngcobo CJ summarized it up as follows:

“An international agreement that has been ratified by resolution of Parliament is binding on South Africa on the international plane. And failure to observe the provisions of this agreement may result in South Africa incurring responsibility towards other signatory states. An international agreement that has been ratified by Parliament under section 231(2), however, does not become part of our law until and unless it is incorporated into our law by national legislation. An international agreement that has not been incorporated in our law cannot be a source of rights and obligations.”<sup>417</sup>

It can then be assumed that the mechanism of the treaty play a major role in the advancement of international tax principles.

#### **4.8 Customary International Law in South African Law**

Customary international law is that source of international law that derives from general state custom or practice accepted as law. With general principles of law recognized by states and treaties, custom is considered to be among the primary sources of international law.<sup>418</sup> In international law a custom will only become binding rule it is satisfactorily widespread or general practice adopted by States and the custom is adopted out of a sense of legal obligation to do so.<sup>419</sup>

As previous mentioned there are two sources of customary international law are *usum* or state practice which must be constant, general and uniform and must be present with specially-affected States and *opinion iuris* or a sense of a legal obligation on States.<sup>420</sup> This implied that there must be a wide, uniform and constant practice of States performed in the belief that such practice is legally required.

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<sup>416</sup>2011 (3) SA 347 (CC).

<sup>417</sup>2011 (3) SA 374 -375 (CC) p 92 G - A.

<sup>418</sup>Hopkins. K. (2005). Can customary international play a meaningful role in our domestic legal order: A short case to consider. South Africa Yearbook of International Law Volume: 30, p 281.

<sup>419</sup>*Ibid* p 281.

<sup>420</sup>Dugard, J. (2011). International Law A South African Perspective, p 59.

The national status of customary international law is governed by section 232 of the Constitution<sup>421</sup> which provides that:

“Customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament”.

This is supported by section 233 of the 1996 Constitution,<sup>422</sup> which states that:

“When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law”

However, it must be noted that section 232 of the Constitution is not a complete statement on customary international law in South Africa, and courts will still have to turn to judicial precedents to decide which rules of customary international law are to be applied and how they are to be proved.<sup>423</sup> Consistently with this, the interpretation clause in the Bill of Rights<sup>424</sup> requires courts, when interpreting the Bill of Rights, to consider international law. The aim of these sections of the Constitution<sup>425</sup> is to confirm that customary international law from part of the law of South Africa unless it is in conflict with the ‘Constitution or an Act of Parliament’.

To determine whether a certain rule constitutes a rule of customary international law, the courts will have to establish whether that rule qualifies as a custom in international practice. To do this the courts will have to apply the twin requirements of *usus* and *opinion iuris*.<sup>426</sup> If this test is satisfied, it will then have to be established whether South Africa has complied with the rule, again through an examination of *usus* and *opinion iuris*. In order to make these determination South African courts has to consult the decisions of international tribunals,

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<sup>421</sup>Constitution of the Republic of South Africa, 1996.

<sup>422</sup>*Ibid.*

<sup>423</sup>Dugard, J. (2011). International Law A South African Perspective, p 50.

<sup>424</sup>Section 39 (1) (b) of the Constitution of the Republic of South Africa, 1996.

<sup>425</sup>Constitution of the Republic of South Africa, 1996.

<sup>426</sup>Dugard, J. (2011). International Law A South African Perspective, p 51.



other courts decisions in which international customary law has been applied and scholarly works.<sup>427</sup>

This abovementioned method was followed in *Kaunda v President of the Republic of South Africa*<sup>428</sup> where Chief Justice Chaskalson had to deliberate whether or not there was a constitutional duty on the Government of South Africa to afford diplomatic protection to its nationals when their fundamental rights were violated in a foreign state.<sup>429</sup> The reasoning behind this was that if such a duty exists under customary international law then under South Africa domestic law there also exists such a duty in the sense of section 232 of the 1996 Constitution.<sup>430</sup> The court majority judgment written by Chief Justice Chaskalson held that:

“diplomatic protection is not recognized by international law as a human right and cannot be enforced as such” and that “diplomatic protection remains the prerogative of the state to be exercised at its discretion. It must be accepted, therefore, that the applicants cannot base their claims on customary international law”.<sup>431</sup>

International customary law requires that before a customary rule of international law can be accepted, there needs to be ‘evidence of a general practice accepted as law’.<sup>432</sup> This test is far too strict. The correct approach is that where a rule of customary international law is accepted by international law as custom then it must be accepted as a binding rule of customary international law by South Africa courts.<sup>433</sup> Once a rule has been established as customary international law then it will become part of South Africa law in of terms of section 232 of

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<sup>427</sup>Hopkins. K. (2005). Can customary international play a meaningful role in our domestic legal order: A short case to consider. South Africa Yearbook of International Law Volume: 30, p 281.

<sup>428</sup>2005 4 SA 235.

<sup>429</sup>Hopkins. K. (2005). Can customary international play a meaningful role in our domestic legal order: A short case to consider. South Africa Yearbook of International Law Volume: 30, p 281.

<sup>430</sup>Section 232 of the Constitution of the Republic of South Africa, 1996.

<sup>431</sup>2005 4 SA 235 par 29.

<sup>432</sup>Dugard, J. (2011). International Law A South African Perspective, p 50.

<sup>433</sup>Hopkins. K. (2005). Can customary international play a meaningful role in our domestic legal order: A short case to consider. South Africa Yearbook of International Law Volume: 30 p 283; Dugard, J. (2011). International Law A South African Perspective, p 52.



the 1996 Constitution. Therefore, there is no distinction between universal and general recognition of customary international law.<sup>434</sup>

#### 4.9 Concluding remarks

From the discussions above the following conclusions about South African DTAs can be made. DTAs are international agreements and are products of public international law. In terms of the Constitution<sup>435</sup> parliamentary ratification are required for all DTAs as they are not of a ‘technical’, ‘administrative’ or ‘executive’ nature. Some of the provisions in South African DTAs are of an administrative nature.<sup>436</sup> However, to keep ratification determines the binding effect of a DTA on the international level and not the domestic law level.

For a DTA to become part of South Africa domestic statutory law it has to be domesticated via legislation, unless the DTA is ‘self-executing’, in which case it need only be approved by Parliament before it becomes law of South Africa domestic statutory law, and provided further that such self-executing provisions of a DTA are not inconsistent with the Constitution or an Act of Parliament. South Africa DTAs are non-self-executing agreements, which means they are judicially enforceable through published in the Government Gazette.

It is submitted that South Africa’s DTAs concluded under the 1996 Constitution are self-executing, in which case s 231(4) of the Constitution 1996, requires that these DTAs need to be approved by Parliament before they become law of general application.

DTAs as treaties are one of the main sources of international law. International law since 1994 clearly enjoys constitutional priority. Under the 1996 Constitution, courts must interpret domestic tax legislation, including all aspects of the Income Tax Act 1962, consistent with international law (provided it does not conflict with the Constitution); effectively meaning that due regard must be had to the large network of bilateral DTAs.

Customary international law has specifically been raised to the constitutional level to under s 232 of the Constitution, 1996. The position under customary international law is heavily in favor of parties to an international agreement refraining from unilateral amendment or

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<sup>434</sup>S v Petane 1998 (3) SA 56 H – J.

<sup>435</sup>Section 231(2) of the Constitution of the Republic of South Africa, 1996.

<sup>436</sup>The mutual agreement procedure (article 25 of the OECD Model Tax Convention), exchange of information between fiscal authorities (article 26 of the OECD Model Tax Convention) and assistance in the collection of taxes (article 27 of the OECD Model Tax Convention).

subversion of their international obligations: for instance, a contracting party to an international DTA cannot invoke any provision of its domestic law as a justification for the failure to perform an obligation arising for it under an otherwise binding treaty.

## 5 CHAPTER 5: SELECTED ISSUES RELATED TO SOUTH AFRICAN DTAs

### 5.1 Introduction

This chapter sets out and discusses the legal status of South African DTAs, enactment of South African DTAs into law through national legislation, interpretation of South African DTA and the South African domestic law position on irreconcilable conflicting provisions between South African DTAs and the Income Tax Act. It then goes on to discuss the application of the common law rules when there is conflict between South African DTAs and the Income Tax Act and whether the anti-discrimination article in South Africa DTAs have the force of law in South Africa.

It is pertinent to mention here that the South African legal system continues to follow a British dualist system with regard to the application of international agreements.<sup>437</sup> In South Africa, the holding of negotiations and the signing of DTAs are within the competence of the national executive of government.<sup>438</sup> Therefore, DTAs are by nature contracts between States concluded by the executive branch of government and not parliamentary legislation. Thus, the negotiation and concluding of DTAs are different from the procedures adopted for domestic statutory statutes in Parliament.<sup>439</sup>

### 5.2 The Legal Status of a South African DTA

Any DTA has a dual nature. Firstly, it is an international bilateral agreement entered into between two contracting States for the assigning of fiscal jurisdiction. Secondly, it becomes part of domestic statutory law of each contracting State, either by direct incorporation or enactment into domestic law.<sup>440</sup>

The 1996 Constitution<sup>441</sup> of the Republic of South Africa is the superior law of the Republic of South Africa. Therefore all South Africa law, which includes statute law, common law,

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<sup>437</sup>Section 231 (4) of the Constitution of the Republic of South Africa.

<sup>438</sup>Chapter 14 and sections 231 to 233 of the Constitution of the Republic of South Africa.

<sup>439</sup>Hattingh, J. (2010). Elimination of International Double Taxation in AP de Koker & Emil Brincker Silke on International Tax, par 36.14.

<sup>440</sup>Victor Uckmar 'Double Taxation Conventions' in Amatucci, A. (2006). International Tax Law, Kluwer International Law, p 149.

<sup>441</sup>Section 2 of the Constitution of the Republic of South Africa, 1996.

international law and international customary law cannot escape the test of constitutionality.<sup>442</sup>

Both the Constitution and the Income Tax Act empowered ‘the national executive of government to enter into an international agreement or treaty, with the government of any other State or territory for the prevention, mitigation or discontinuance of the levy of tax by both governments in respect of the same income’.<sup>443</sup> Normally this authority is delegated to the Minister of Finance as he is part of the national executive, which officials enters into DTAs on behalf of the Republic of South Africa.

The Constitution<sup>444</sup> determines that an international agreement is binding on the Republic of South Africa once it has been approved by resolution in Parliament. Approval by Parliament means approval by both houses of Parliament, (the National Assembly and the National Council of Provinces). A DTA is presented with an advisory memorandum which explains to the members of Parliament what the DTA what to achieve.<sup>445</sup> However, technical, administrative or executive international agreement or an international agreement which does not require either ratification or accession, entered into by the executive branch of government is exempted from the requirement of ratification.<sup>446</sup> After signature, these agreements must be tabled in both houses of Parliament within a reasonable time, but for information purposes only.<sup>447</sup> Some academic writes have different views on the position of whether DTAs are self -executing or not self – executing.<sup>448</sup>

In *Glenister v President of the Republic of South Africa and Others*<sup>449</sup> the majority judgment held that the core purposes of section 231(2) of the Constitution is concentrating at South

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<sup>442</sup>*Ibid.*

<sup>443</sup>*Ibid* section 231(1) and section 198 (1) Act 58 of 1962.

<sup>444</sup>Section 231 (2) of the Constitution of the Republic of South Africa, 1996.

<sup>445</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 294.

<sup>446</sup>Scholtz, W. (2004). A few thoughts on section 231 of the South African Constitution, Act 108 of 1996, *South African Yearbook of International Law*, Volume: 29, p 208.

<sup>447</sup>*Ibid.*

<sup>448</sup>Du Plessis, I. (2012) Some Thoughts on the Interpretation of Tax Treaties in South Africa, *SA Merc LJ*, Volume: 24, p 32, fn 10.

<sup>449</sup>2011 (3) SA 347 (CC).

Africa's rights and obligations and that the provisions must be read in combination with other provisions within section 231 of the Constitution.<sup>450</sup> The court further noted that:

“The fact that s 231 (4) expressly creates a path for the domestication of international agreements may be an indication that s 231 (2) cannot without more, have the effect of giving binding internal constitutional force to agreements merely because Parliament has approved them. It follows 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.”<sup>451</sup>

The significances of enactment of a DTA into South African law under section 231 (4) of the Constitution is that the DTA become part of South African Law. The aim of section 108 (2) of the Income Tax Act is therefore to guarantee that domestic statutory obligations are created.<sup>452</sup> Incorporation of a DTA through section 108 (2) of the Income Tax Act led to a DTA become part of South Africa domestic statutory law.<sup>453</sup> It also led to the creating of ordinary statutory obligations.<sup>454</sup> Ngcobo CJ in *Glenister v President of the Republic of South Africa* stated the status of an international agreement as follows:

“... It is implicit, if not explicit, from the scheme of s 231 that an international agreement becomes law in our country enjoy the same status as any other legislation. This is so because it is enacted into law by national legislation, and can only be elevated to a status superior to that of other national legislation if Parliament expressly indicates its intent that the enacting legislation should have such status.”<sup>455</sup>

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<sup>450</sup>2011 (3) SA 347 (CC), par 181.

<sup>451</sup>*Ibid.*

<sup>452</sup>CSARS v Van Kets 2012 (2) All SA 413 (WCC), par 16.

<sup>453</sup>Per Ngcobo CJ, delivering the minority judgment in *Glenister v President of the Republic of South Africa* 2011 (3) SA 347 (CC), par 100.

<sup>454</sup>Per Moseneke DCJ and Cameron J, delivering the majority judgment in *Glenister v President of the Republic of South Africa* 2011 (3) SA 347 (CC) par 181; Du Plessis, I. (2012) Some Thoughts on the Interpretation of Tax Treaties in South Africa, *SA Merc LJ*, Volume: 24, p 33; CSARS v Van Kets 2012 (3) SA 399 (WCC), par 15 - 16.

<sup>455</sup>2011 (3) SA 347 (CC) 377, par 100.

In *Commissioner, South African Revenue Service v Van Kets*<sup>456</sup> the court had to determine the legal status of an amended clause in the South Africa / Australian DTA. The Australian Tax Office ('ATO') requested information from South African Commissioner for Revenue Services ('SARS') on a person suspected of evading his Australian tax obligations. The request was made in terms of the applicable DTA. The information was known to a South African resident: Werner Van Kets. In seeking the information from Van Kets, SARS relied on provisions of the Income Tax Act requiring the furnishing of information to SARS. The court refer to section 231 (1) and (4) of the Constitution and majority judgment in *Glenister v President of the Republic of South Africa*<sup>457</sup> and concluding that 'the effect of s 108 (2) is thus to ensure that domestic obligations are created'.<sup>458</sup> The court further held after referring to Oliver & Honiball<sup>459</sup> that the provisions of a DTA rank similarly with domestic law, including with the Income Tax Act and the provisions of the DTA and the Act must 'be reconciled and read as one coherent whole'.<sup>460</sup>

The court also had the opportunity to articulate on the status of a DTA in *Commissioner, South African Revenue Service v Tradehold Limited*<sup>461</sup> This case dealt with the deemed disposal of assets due to a change in the resident status of a taxpayer and the relevant Income Tax Act provision was paragraph 12 of Eighth Schedule of Act 58 of 1962. The court considered the paragraph's interaction with the DTA between the Republic of South Africa and Luxembourg and the meaning of and effect of Article 13(4). The court held that Article 13(4) of the DTA includes within its ambit capital gains derived from the alienation of all property including a deemed disposal of assets. The court further held that section 108 of the Income Tax Act is an 'enabling legislation and 'once brought into operation a DTA has the

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<sup>456</sup>2012 (3) SA 399 (WCC); (2011) 74 SATC 9.

<sup>457</sup>Per Moseneke DCJ and Cameron J, delivering the majority judgment in *Glenister v President of the republic of South Africa* 2011 (3) SA 347 (CC), par 181.

<sup>458</sup>*CSARS v Van Kets* 2012 (3) SA 399 (WCC), par 16.

<sup>459</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 305.

<sup>460</sup>*CSARS v Van Kets* 2012 (3) SA 399 (WCC), par 25.

<sup>461</sup>2012 3 All SA 15 (SCA); (2012) 74 SATC 263.

effect of law'.<sup>462</sup> The court described the 'legal effect' of a DTA as follows by quoting this passage by Corbett JA in *SIR v Downing*:<sup>463</sup>

"The effect of proclamation is that, as long as the convention is in operation, its provisions, so far as they relate to immunity, exemption or relief in respect of income in the Republic, have effect as if enacted in Act 58 of 1962 (see sec. 108 (2))".

This would mean that a DTA has the same status as any other provision of the Income Tax Act.<sup>464</sup> However, South Africa courts, as final arbiters in interpreting South African DTAs, have generally applied principles of interpretation to DTAs that are different from those pertinent to domestic statutes.<sup>465</sup>

A DTA will always fall within the ambit of section 231(2) of the Constitution as it has financial implications for the Republic of South Africa and will only be binding if approved by both houses of Parliament.<sup>466</sup> Once a DTA has been ratified by resolution of both houses of Parliament it constitutes a binding contract between the signatory States. Failure to observe the provisions of DTAs may result in South Africa incurring responsibility towards other contracting States.<sup>467</sup>

### **5.3 South Africa DTAs enactment into law by national legislation**

Once there has been compliance with the constitutional requirements,<sup>468</sup> a DTA is binding *inter partes*, between South Africa and the other contracting State. This, however, does not mean that it has become part of South African domestic law. For an DTA to be incorporated into South African domestic law, section 231 (4) of the Constitution requires, in addition to

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<sup>462</sup>*Ibid* par 15 -16.

<sup>463</sup>1975 (4) SA 518 at 523A.

<sup>464</sup>Du Plessis, I. (2012). Some Thoughts on the Interpretation of Tax Treaties in South Africa, *SA Merc LJ*, Volume: 24, p 32, fn 18.

<sup>465</sup>ITC 1503 53 SATC 342 (T).

<sup>466</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 295.

<sup>467</sup>Per Ngcobo CJ, delivering the minority judgment in *Glenister v President of the Republic of South Africa* 2011 (3) SA 347 (CC), par 92.

<sup>468</sup>Section 231 the Constitution of the Republic of South Africa, 1996.

the resolution of Parliament approving the DTA, further national legislation is required for enactment into domestic law.<sup>469</sup>

There are three methods through how Parliaments can enactment DTAs into domestic law.<sup>470</sup> Firstly, a separate new Act must be made by Parliament, incorporating the DTA. This means that that the new Act must has the DTA as part of its content; secondly, the DTA may be annexed as a schedule to an existing statute and thirdly, there must be an enabling Act of Parliament (i.e. Income Tax Act) in domestic legislation which give the executive the authority for the incorporation of a DTA into the domestic law by means of proclamation in the government gazette.<sup>471</sup>

Section 108(2) of the Income Tax Act<sup>472</sup> is the enabling provision that provides that DTAs are deemed to be part of the Income Tax Act once it have been approved by both houses of Parliament as required in section 231(4) of the Constitution of the Republic of South Africa<sup>473</sup> and published in the government gazette (so-called direct effect approach).<sup>474</sup> The effect of publication of a DTA in the government gazette is that the DTA become part of South Africa domestic law and it is applicable to all South Africa residents and resident of the other Contracting States.<sup>475</sup> Therefore, there is no doctrine of paramountcy provision for South Africa's DTAs.<sup>476</sup> Thus, the effect of section 108<sup>477</sup> is that domestic statutory obligations are created.<sup>478</sup>

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<sup>469</sup>Du Plessis, I. (2012) Some Thoughts on the Interpretation of Tax Treaties in South Africa, *SA Merc LJ*, Volume: 24, p 33.

<sup>470</sup>Dugard .J. (2011). *International Law: A South African Perspective*, p 55.

<sup>471</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 289 -290.

<sup>472</sup>Constitution of the Republic of South Africa, 1996.

<sup>473</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 303.

<sup>474</sup>Section 108 (2) of Act 58 of 1962 read with section 231 of the Constitution of the Republic of South Africa,1996, *CSARS v Van Kets* [2012] 2 All SA 416 (WCC) a - b.

<sup>475</sup>*CSARS v Tradehold Ltd* 2012 JOL 28890 (SCA) p 8 par 16.

<sup>476</sup>Wills, M. (1995). *South African Double Tax Treaties: Royalty Reform in the Light of the Australian Experience*, *Revenue Law Journal*, Volume: 5, Issue 1, p 63.

<sup>477</sup>Act No. 58 of 1962.

<sup>478</sup>*CSARS v Van Kets* (2012) 2 All SA 416 (WCC) h.



However, there is a view that section 108 (2) of the Income Tax Act is not a proper enacting legislation. The reason been is that South Africa unlike the United Kingdom does not enact separate statutes for each DTA that it concluded. Therefore, enactment of national statute is not required.<sup>479</sup> It can thus be argued that the court in *Commissioner, South African Revenue Services v Tradehold Ltd*<sup>480</sup> by referring to section 108 of the Income Tax Act as ‘enabling legislation’ is of the opinion that section 108 function as the national statute which is required to enactment the DTA entered into by the national executive.<sup>481</sup>

#### 5.4 Interpretation of South African DTAs through South African Tax Case Law

There appears to be an agreement that South Africa DTAs are negotiated contracts between sovereign states and are generally intending to be relieving.<sup>482</sup> Tax law cases exist in South Africa that has confirmed the general approach to interpretation of South African DTAs. The leading case in this context is the Supreme Court decision in *Secretary for Inland Revenue v Downing*,<sup>483</sup> where the Court was called upon to interpret a provision in the DTA between South Africa and Switzerland. The DTA was based on the 1963 OECD MTC, and was enactment by virtue of section 108(2) of the Income Tax Act and therefore it was held to have effect as though enacted into the Income Tax Act.<sup>484</sup> The court confirmed the use of the OECD MTC as a basis for South African DTAs:

“This model has served as the basis for the veritable network of double taxation conventions existing between this country and other countries and between many other countries *inter se*”.<sup>485</sup>

The significant of this case is that the court recognized the existence of an ‘international tax language’. It is also recognize established principles of international public law, when faced

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<sup>479</sup>Hattingh, J. (2010). Elimination and Avoidance of International Double Taxation in AP de Koker & Emil Brincker *Silke on International Tax*, p 36.14.

<sup>480</sup> 2012 3 All SA 15 (SCA); (2012) 74 SATC 263.

<sup>481</sup>Du Plessis, I. (2012) Some Thoughts on the Interpretation of Tax Treaties in South Africa, *SA Merc LJ*, Volume: 24, p 38.

<sup>482</sup>De Koker, AP (2010). ‘Introduction’: AP de Koker & Emil Brincker, *Silke on International Tax*, par 1.3.

<sup>483</sup>1975 (4) SA 518 (AD); (1975) 37 SATC 249.

<sup>484</sup>Act No. 58 of 1962.

<sup>485</sup>1975 (4) SA 518 (A) 523 A – B.

with issues of interpretation in respect of DTAs, the ‘international flavor’ of the terms used, which, according to the court, may require deviation from known domestic approaches to interpretation of legislation.

In *Commissioner of Taxes v Aktiebolaget Tetra Pak*<sup>486</sup> where the appeal concerns the interpretation of a DTA between Britain and Sweden which was extended to the Federation of Rhodesia (now Zimbabwe) and Nyasaland (now Zambia). The case dealt with a Swedish company which manufactures and sells laminated paperboard for the use in the making of containers for the packaging of milk and other liquids. It also manufactures machines which convert the laminated paperboard into containers for the packaging of liquids. The Swedish company had no permanent establishment in Rhodesia but lease two firms in Rhodesia six of its machines. The issue before the court was whether or not the income derived by the Swedish company from the leasing of its machines can be considered to be an “industrial or commercial profit” within the meaning of the DTA. The court set out the framework for deciding the issue as follows:

“In interpreting the term the ordinary rules of construction applicable to the interpretation of municipal statutory instrument must apply. The object of a statutory instrument is often a useful aid to interpretation and here it must be borne in mind that the object of this particular instrument is to avoid double taxation. All other things being equal, therefore, an interpretation which achieves this object should be favored above one which does not”.<sup>487</sup>

The relevancy of this judgment is that it was not followed in the *Downing* case.

The Cape Special Court in *ITC 1473*,<sup>488</sup> the appellant a citizen of West Germany wrote a letter to the Receiver of Revenue in Cape Town on his understanding of an article between South Africa and West Germany DTA. The Special Court refers to the aforementioned letter to back its interpretation of the relevant article without providing any grounds for doing so. The relevancy of this case is that it confirms a well-known principle of international public law, preparatory work to a DTA (*travaux préparatoires*) may be consulted as a supplementary means to confirm the meaning of a DTA. This preparatory work could include

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<sup>486</sup> 1966 (4) SA 198 (RA); (1966) 28 SATC 213 1925 (TPD).

<sup>487</sup> *Ibid* p 201.

<sup>488</sup> (1989) 52 SATC 128 (C).

letters written by one revenue authority to another regarding the meaning of a particular article in a DTA at the time of its conclusion.

The issue to be decided in *ITC 1503*<sup>489</sup> was whether the interest which accrued from the credit in the current account of the appellant at the A bank fall within or outside the scope of the provisions of the DTA between the Government of South Africa and the B State Government resulting from the business of sea or air transport. Melamet J said that:

“The meaning of the agreement must be determined according to the principles governing the interpretation of contracts in the Republic of South Africa. The court must determine what the language of the document would ordinarily be understood to mean. It matters not, in my view that on proclamation the arrangements therein contained shall insofar as they relate to immunity, exemption, or relief from taxation in the Republic have the effect as if enacted in the Income Tax Act (s 108(2) refers). Passos Tax Treaty Law pp 67-8.”<sup>490</sup>

and;

“We are of the opinion that on the principle laid down in the commentary to the OECD convention that the interest earned in the present case is from an ancillary activity if not part of the operation of the aircraft.”<sup>491</sup>

Melamet J in *ITC 1544*<sup>492</sup> two years later after his decision in *ITC 1503* again addressed the interpretation of DTAs problem and stated that:

“The terms of a double tax convention on which statutory status has been conferred are to be considered as any other statutory provisions to determine the extent to which these conflict with the provisions of another statute and whether such provisions have been modified thereby”.<sup>493</sup>

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<sup>489</sup>(1991) 53 SATC 342 (T).

<sup>490</sup>*Ibid* p 347.

<sup>491</sup>*Ibid* p 348.

<sup>492</sup>(1992) 54 SATC 456(T).

<sup>493</sup>*Ibid* p 460.

In *ITC 1544*<sup>494</sup> the issue was whether the non – discrimination article in the DTA between South Africa and the United Kingdom was been floated when South Africa imposes non-resident shareholders tax (‘NRST’) on dividends received by a non-South Africa company. The court concluded that Article 25 of the DTA (the non – discrimination clause) is a special provision appearing later in the DTA and in the event of conflict with previous articles of a general nature it should prevail.

The dispute in *ITC 1735*<sup>495</sup> was whether payment made to taxpayer (one of the world’s leading golf professionals) constituted a royalty as defined in Article 11 of the DTA entered into between South Africa and the United Kingdom/Northern Ireland. The appellant argument was whether his name, likeness and biographical material were property in respect of which he owned the copyright. The court held that copyright has gone far beyond the generally perceived scope of the word copyright. The Appellant had placed no evidence before the court that any of the items over which he alleged he owned the copyright were the result of his skill and effort.<sup>496</sup> In the same case the Court endorsed another not specifically defined DTA term ‘athlete’ to the ‘modern ordinary meaning of athlete.’ The court referred to the work by Klaus Vogel to determine the ‘modern ordinary meaning’ of the word.<sup>497</sup>

In *A M Moolla Group Ltd v Commissioner, South African Revenue Service*<sup>498</sup> the issue was whether certain goods imported by the A M Moolla Group Ltd from Malawi are exempt from customs duty under the trade agreement concluded between South Africa and Malawi agreement and the Customs and Excise Duty Act.<sup>499</sup> The legal question the Court had to answer was the interpretation to be given to an article in the trade agreement. The trade agreement was domesticated as part of the Customs and Excise Duty Act. The Court held that if there is conflict among general provisions of the Customs and Excise Duty Act and provisions of the trade agreement the Customs and Excise Duty Act will prevail. The trade agreement once domesticated forms part of the Customs and Excise Duty Act; hence the

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<sup>494</sup>(1992) 54 SATC 456 (T).

<sup>495</sup>(2002) 64 SATC 455.

<sup>496</sup>*Ibid* p 463.

<sup>497</sup>*Ibid* p 464.

<sup>498</sup>2003 (6) SA 244 (SCA); (2003) 65 SATC 414 (SCA).

<sup>499</sup>Act 91 of 1964.

interpretation of the trade agreements articles must be amendment when the Customs and Excise Duty Act is altered. The Court further held that, unless the context indicates the contrary, that where words which are defined in the Customs and Excise Duty Act arise in the trade agreement, they must be given the meaning allocated to them by the Customs and Excise Duty Act.<sup>500</sup>

The interpretation of an article within South Africa / Lesotho DTA was the issue at hand in *Grundlingh v Commissioner for the South African Revenue Service*.<sup>501</sup> This case involved many interesting issues in international tax law. Was the partnership an “enterprise” of Lesotho under the meaning of that term in the South Africa /Lesotho DTA? Had the South African attorney created a “permanent establishment” in terms of the DTA in Lesotho? The Court missed an opportunity to consider the OECD comprehensive report on the tax treatment of partnerships under a DTA. Unfortunately, even though assistance could have been obtained from the OECD MTC or international tax case law in deciding this case, no reference of any kind was made.<sup>502</sup>

In *Commissioner, South African Revenue Service v Van Kets*<sup>503</sup> the High Court of the Western Cape was called upon to decide on the application of the exchange of information article as contained in the South Africa / Australia DTA. Davis J makes the following observations regarding the interpretation of a DTA:

“It would thus appear as if the DTA provisions become part of domestic income tax laws. Given the manner in which the DTA stands to be treated in terms of s 231 of the Constitution, its provisions must rank at least equally with domestic law, including the Act. For this reason the provisions of the DTA and the Act should, if at all possible, be reconciled and read as one coherent whole”.<sup>504</sup>

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<sup>500</sup>2003 (6) SA 244 (SCA) par 15.

<sup>501</sup>2009 ZAFSHC 99; (2009)72 SATC 1.

<sup>502</sup>Brincker, E. (2010). ‘The Conclusion and Force of Double Taxation Agreements’: AP de Koker & Emil Brincker, *Silke on International Tax*, par 12.8.8.

<sup>503</sup>2012 (3) SA 399 (WCC); (2011) 74 SATC 9.

<sup>504</sup>*Ibid* par 25.

A recent South African case on the interpretation of DTAs was *Commissioner for the South African Revenue Service v Tradehold Ltd.*<sup>505</sup> In 2000 a DTA between South Africa and Luxembourg was entered into which deems a company resident in both States to be resident, for purposes of the application of the DTA, wholly in the country where the effective management of that company is located. Despite the change in Tradehold's place of effective management, it was still resident in South Africa by virtue of its incorporation in South Africa until the abovementioned amendment to the definition of 'resident' combined with the existence of the DTA resulted in it becoming exclusively resident in Luxembourg.

Regarding the interpretation of the DTA, Boruchowitz AJA held that:

“... In interpreting its provisions one must therefore not expect to find an exact correlation between the wording in the DTA and that used in the domestic taxing statute. Inevitably, they use wording of a wide nature, intended to encompass the various taxes generally found in the OECD member countries. In addition, because the double tax agreements are intended to encompass not only existing taxes, but also taxes which may come into existence at later dates (see Art 2(2)), and bearing in mind the complex nature of taxation in the various member countries, inevitably the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute...”<sup>506</sup>

In interpretation a DTA the court adopted the approach of United Kingdom court and stated:

“...that the first step in any interpretive inquiry is to ascertain where in the scheme of the double tax agreement the relevant tax falls, and then to consider whether the tax can be imposed consistently with the obligations undertaken there under.”<sup>507</sup>

DTAs should be interpreted in a manner which gives effect to the purpose of the DTA and is consistent with the words use in the DTA. The court further stated that the correct manner in which a DTA should be interpreted is as follows:

“The first step therefore is to determine into which Article of the DTA the particular tax falls. Article 2 of the DTA specifies the taxes to which it applies. With regard to

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<sup>505</sup>Commissioner for the South African Revenue Service v Tradehold Ltd [2012] 3 All SA 15 (SCA); (2012) 74 SATC 263.

<sup>506</sup>*Ibid* par 18.

<sup>507</sup>Commissioner for the South African Revenue Service v Tradehold Ltd [2012] 3 All SA 15 (SCA), par 18.

the Republic, it is said to apply to ‘the normal tax’, which includes tax on capital gains. It is plain that the parties to the DTA intended that all taxes referred to in Art 2 would be dealt with in one or other of the articles of the DTA.”

The recognition of the importance of the OECD MTC in the *Tradehold case* will induce other courts to refer to OECD material, albeit without guidance from this court regarding the grounds for such reference.

It is submitted that from South African case law that there are three major opinions regarding the interpretation of South African DTAs. According to the *Tradehold case* a DTA obligations trumps the Income Tax Act. According to the *AM Moola case*, The Income Tax Act trumps the DTA. In the *Van Kets case* the DTA and the Income Tax Act rank equally and the provisions of both should ‘be reconciled and read as one coherent whole’.

### **5.5 Irreconcilable conflicting issues between South African DTA and the Act**

South African DTAs does not have a special or privileged status under South African law unless transformed into South African domestic law.<sup>508</sup> The Income Tax<sup>509</sup> does not provide any assistance, where there is a conflict between the DTA and the Act. However, section 231 (4) of the Constitution states:

“Any international agreement becomes law in the republic when it is enacted into law by national legislation ...”

It would thus appear that the provision of a DTA becomes part of the domestic law and that its provisions must rank at least equally with Income Tax Act.<sup>510</sup> Therefore, the provisions of the DTA and the Income Tax Act should ‘be reconciled and read as one coherent whole’.<sup>511</sup>

There are no clear guidelines in the Constitution or Income Tax Act on how to reconcile conflict provisions between the Act and the DTA. If there is conflict between a DTA that has

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<sup>508</sup>Pan American World Airlines Inc. v SA Fire & Accident Insurance Co Ltd 1965 (3) SA 150 (A), p 161C -D.

<sup>509</sup>Section 108 (2) of Act No. 58 of 1962.

<sup>510</sup>Du Plessis, I. (2012). Some Thoughts on the Interpretation of Tax Treaties in South Africa *SA Merc LJ*, Volume: 24, p 34.

<sup>511</sup>Olivier, L. & Honiball, M. (2011). International Tax A South African Perspective, p 305; CSAR v Van Kets 2012 (2) All SA 413 (WCC) 419, par 25.



been enactment into South Africa law and the Income Tax Act, that conflict must be resolved by the application of the normal principles of statutory interpretation.<sup>512</sup>

As mentioned earlier the issue in *AM Moola Group Ltd and Others v C: SARS and Others*<sup>513</sup> was the interpretation to be given to article 6 (ii) of Trade Agreement between South Africa and Malawi which had been promulgated as part of the Customs and Excise Act.<sup>514</sup> Lewis JA held as follows, that:

“... If there were to be an apparent conflict between general provisions of the statute and the particular provisions of an agreement, difficulties of interpretation might indeed arise. The Act, must, of course, prevail in such a case: the agreement once promulgated is by definition part of the Act. It must be follow that where words which are defined in the Act occur in the agreement, they must be given the meaning assigned to them by the Act unless the context indicates the contrary”.<sup>515</sup>

In the minority judgment of *Glenister v President of the Republic of South Africa*<sup>516</sup> the court held the following regarding conflict between domestic statutory legislation and international agreement:

“... In addition, the amicus also accepted, quite properly, that, if there is a conflicted between an international agreement that has been incorporated into our law and another piece of legislation, that conflict must be resolved by the application of the principles and superseding of legislation”.

In *Commissioner, South African Revenue Services v Tradehold Ltd* the court held that to the extent that there is any conflict between DTA and domestic law provisions a DTA will alter the domestic law and will apply in preference to the domestic law.<sup>517</sup>

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<sup>512</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 315.

<sup>513</sup>2003 (6) SA 244 (SCA), 2003 65 SATC 414 (SCA).

<sup>514</sup>Act No.91 of 1964.

<sup>515</sup>2003 (6) SA 244 (SCA), par 15.

<sup>516</sup>Per Ngcobo CJ, delivering the minority judgment in *Glenister v President of the Republic of South Africa* 2011 (3) SA 347 (CC), par 101.

<sup>517</sup>2012 3 All SA 15 (SCA) par 17.



Therefore, there is clearly a conflict between the *AM Moolla* judgment, *Tradehold Ltd* judgment and the minority judgment in *Glenister* case. The *AM Moolla* case recommends that the provisions of the Customs and Excise Act triumph over an international trade treaty which forms part of the Customs and Excise Act, whereas the minority judgment in *Glenister* case is of the view that the conflict must be resolved by the application of the principles of domestic statutory interpretation.<sup>518</sup> In the *Tradehold Ltd* case the Supreme Court assessment was that a DTA amends the domestic statutory law and will apply in preference to the domestic statutory law to the point that there is any conflict. In South Africa it is submitted that there are three different views regarding the conflict provisions between the Income Tax Act and DTAs.<sup>519</sup>

Wilson has set out the following principles that should be adhered to in practice in establishing the interaction between a DTA and domestic statutory laws. Firstly, a DTA should not be referred to if there is no conflict, because it is unlikely to be of assistance. Secondly, the domestic law may discharge the conflict. Thirdly, there may be a domestic solution but the DTA may offer a better solution that differs from the domestic solution.<sup>520</sup> It is therefore suggested that in the case of conflict between the provisions of a DTA and the Income Tax Act, the normal principles of statutory interpretation should be followed to resolve the conflict. These normal principles of interpretation include the common law rules.

## **5.6 Common Law Rules where there is conflict between Income Tax Act and DTAs**

The interpretation of fiscal statutes demand a different approach to that adopted in the interpretation of ordinary statutes, particularly as the result of the *dictum inpretatio contra fiscum adhibenda*.<sup>521</sup> The *contra fiscum* rule as it is known in South Africa law provides that a taxing statute must be interpreted in favor of the taxpayer where its reveals ambiguity.<sup>522</sup> The *contra fiscum* rule seems like a specific application of the general rule that all legislation which imposing a burden upon the taxpayer should, in the case of an uncertainty, be

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<sup>518</sup>Du Plessis, I. (2012) Some Thoughts on the Interpretation of Tax Treaties in South Africa *SA Merc LJ*, Volume: 24, p 34.

<sup>519</sup>*Ibid* p 35.

<sup>520</sup>Wilson, I. (2003). International tax –VI, 17 Tax Planning, p 131.

<sup>521</sup>(1996). The Taxpayer, Volume: 45, p 24.

<sup>522</sup>*Estate Reynolds and Others v CIR*, 1937 AD 57, p 70.

construed in favor of the taxpayer. Anon<sup>523</sup> said the following about the *contra fiscum* rule and the liberty of individuals:

“Thus, the presumptions in favour of the liberty of the individual against excessive burdens, and the interpretation of fiscal statutes *contra fiscum*, represents the view that the institution of Parliament has to uphold the liberty of the individual and that, unless expressly stated to the contrary, legislation must be interpreted to preserve that idea.”<sup>524</sup>

The *contra fiscum* rule has been applied in South Africa. In *Glen Anil Development Corporation Ltd v SIR*<sup>525</sup> Botha JA said this:

“Apart from the rule that in the case of an ambiguity a fiscal provision be construed *contra fiscum* ... which is but a specific application of the general rule that all legislation imposing a burden upon the subject should, in the case of an ambiguity, be construed in favour of the subject ...”<sup>526</sup>

It must also be remembered that the ‘*contra fiscum*’ rule does not apply to the interpretation of anti-avoidance provisions of the Income Tax Act. The *contra fiscum* rule will not apply as the provisions of a DTA are part of the Income Tax Act and the main object of a DTA is tax avoidance. However, where there is no tax –avoidance is present the *contra fiscum* rule might apply.<sup>527</sup>

Another generally international accepted technique of interpretation rule or maxim of interpretation that can resolve irreconcilable conflict between provisions of the DTA and the Income Tax Act is the *lex posterior derogat priori* (‘the later statute amends the earlier one’). It suggested that when there are two conflict sections in a statute and both are of a general

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<sup>523</sup>(1996). The Taxpayer, Volume: 45, p 24.

<sup>524</sup>*Ibid* p 28.

<sup>525</sup>1975 (4) SA 715 (AD); (1975) 37 SATC 319.

<sup>526</sup>1975 (4) SA 715 (AD) 727 F,(1975) 37 SATC 334; See also *CIR v Whitfield* 1993 2 SA 236 (ECD) 240 G,(1992) 55 SATC 163; *Law Society Transvaal v Minister of Constitutional Development and Planning* 1989 4 SA 914 (T),(1989) 51 SATC 195 203; *SBI v Raubenheimer* 1969 4 SA 314 (A) 322 D,(1969) 31 SATC 209 218; *Estate Reynolds & Others* 1937 AD 57,(1937) 8 SATC 203 213.

<sup>527</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 318.

nature on the same matter then the later one usually prevails.<sup>528</sup> It applies when there are conflicting sections in different statutes and both statutes are of a general nature.<sup>529</sup> In *Sasol Oil (Pty) Ltd & another v Metcalfe NO*<sup>530</sup> Willis J, referred to this maxim by noting that:

“It is trite that, in the interpretation of ordinary statutes, to the extent that there is inconsistency between earlier and subsequent legislation, the provisions of the subsequent legislation will ordinarily prevail”,<sup>531</sup>

It is clear that the principle operating in the *lex posterior* rule is that of a later statute impliedly repeals an earlier one. In *Government of the Republic of South Africa v Government of KwaZulu*.<sup>532</sup> Rabie CJ held that the latter statute had impliedly amended the former one, and that the South African Government’s decision to excise certain portions of the territory of Ingwavuma from KwaZulu was invalid and consequently illegal.<sup>533</sup> This rule applies unless the relevant section of the earlier statute is deemed to be specific, in which case the *generalia specialibus non derogant* maxim applies.<sup>534</sup>

A court must look at the respective dates that the DTA came into operation and the date of introduction of the domestic Income Tax Act in order to apply this rule.<sup>535</sup> By applying this maxim may also result in domestic legislation later passed overriding a DTA provision.<sup>536</sup> This may conflict with the international obligations of South Africa, as a DTA is seen as representing a binding contract between two contracting States.<sup>537</sup>

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<sup>528</sup>Steyn, L.C. (1981). Die Uitleg van Wette, p 188.

<sup>529</sup>*Ibid* p 188.

<sup>530</sup>2004 (5) SA 161 (W).

<sup>531</sup>*Ibid* p 165E.

<sup>532</sup>1983 (1) SA 164 (A).

<sup>533</sup> *Ibid* p 2001 E - G.

<sup>534</sup>*Khumalo v Director-General of Co-operation and Development* 1991 (1) SA 158 (A), p 165 F – 166 G.

<sup>535</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 305; Oguttu, A, W. (2010). *The Challenges of Taxing Profits Attributed to Permanent Establishments: A South African Perspective*, SA *Merc LJ*, Volume: 21, p 797.

<sup>536</sup>Oguttu, A, W. (2010). *The Challenges of Taxing Profits Attributed to Permanent Establishments: A South African Perspective*, SA *Merc LJ*, Volume: 21, p 798.

<sup>537</sup>*Ibid*.

Another contradictory related principle is the Latin maxim *generalia specialibus non derogant* (specific law overrides general law)). In terms of this maxim, where a subsequent statute deals with a matter in general terms, it should not be construed to alter or derogate from a previous statute or common law which dealt with a matter exhaustively.<sup>538</sup> The *generalia specialibus non derogant* maxim is applicable to the resolution of conflicts between general and special laws.<sup>539</sup> The Supreme Court of Appeal explained in *Transnet Ltd and others v Chirwa*<sup>540</sup> this maxim as follows:

“Steyn Die Uitleg C van Wette cites a passage from the speech of Lord Hobhouse in *Barker v Edger* (reproduced in *R v Gwantshu*):

'The general maxim is *generalia specialibus non derogant*. When the Legislature has given attention to a separate subject and made provision for it the presumption is that a subsequent general enactment is not intended to interfere with the special provision, unless it manifests that intention very clearly. Each enactment must be construed in that respect according to its own subject-matter and its own terms.'

The maxim is actually only a presumption which may be rebutted by a clear expression of intent in a later general act. For instance, in *New Modderdam Gold Mining Co v Transvaal Provincial Administration*<sup>541</sup> Kotzé AJA observed the following:

“if this last Act professes, or manifestly intends, to regulate the whole subject to which it relates, it necessarily supersedes and repeals all former acts, so far as it differs from them in its prescriptions”.<sup>542</sup>

However, it should be noted that the application of the *generalia specialibus non derogant maxim* is sometimes complicated, as Quenet JP in *R v Landman*,<sup>543</sup> explained:

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<sup>538</sup>Steyn, L.C. (1981). *Die Uitleg van Wette*, p 190; Devenish, G. E. (1992). *Interpretation of Statutes*, p 280.

<sup>539</sup>Steyn, L.C. (1981). *Die Uitleg van Wette*, p 190.

<sup>540</sup>2007 (2) SA 198 (SCA), p 214 C - D.

<sup>541</sup>1919 AD 367.

<sup>542</sup>*Ibid* p 397.

<sup>543</sup>1966 (3) SA 679 (RA).

“But the maxim is simply an aid to interpretation and does not itself provide a ready answer. All too often statutes which have to be construed are both special and general, depending upon the angle from which they are viewed”.<sup>544</sup>

This maxim was successfully argued in *S v Kukarie*<sup>545</sup> where the court had to interpret section 2 of the Abuse of Dependence producing Substances and Rehabilitation Centres Act<sup>546</sup>. Here it was held that, since the punishment laid down in section 2 for the contravention of the Act was framed in general terms, section it did not override the special forms of punishment prescribed for youths in s 345 of the Criminal Procedure Act.<sup>547</sup>

In terms of this rule of interpretation, it can be reasoned that a DTA entered after the Income Tax Act is a general enactment and cannot derogate from the provisions contained in the Income Tax Act which regulating a specific type of relationship.<sup>548</sup> The Income Tax Act is a general statute enacted long before the DTA. It regulates in general terms the relationship between all South Africa taxpayers and the South African Revenue Services (‘SARS’), while the DTA as an international agreement regulates the relationship between taxpayers of the two States exhaustively. Thus, DTAs should be interpreted more widely than the Income Tax Act.<sup>549</sup> This may require taking international interpretational rules into consideration.<sup>550</sup>

### **5.7 Does the anti-discrimination article in South Africa DTAs have the force of law in South Africa Law?**

After a DTA has been approved by the South African Parliament and it has been published in the government gazette the question arise whether there can still be an argument that a provision in that DTA falls outside the scope of section 108 of the Income Tax Act? Most of South Africa DTAs with other contracting States contain Article 24 (headed Non-discrimination) which is identical to Article 24 of the OECD MTC. The aim of Article 24 of

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<sup>544</sup>*Ibid* p 681E.

<sup>545</sup>1972 (2) SA 907 (O), p 913 B – E.

<sup>546</sup>Act No. 41 of 1971.

<sup>547</sup>Act No.56 of 1955.

<sup>548</sup>Oguttu, A. W. (2010).The Challenges of Taxing Profits Attributed To Permanent Establishments: A South African Perspective. *SA Merc LJ*, Volume: 21, p 798.

<sup>549</sup>*Ibid* p798.

<sup>550</sup>See Chapter 3 of this thesis for a discuss on international interpretational aspects of DTAs.

the OECD MTC is to prohibit certain forms of discrimination by a contracting State. The provision of Article 24 does not address all practices of potential discriminations.

Article 24 of the OECD MTC identify four conditions which domestic tax law of a contracting States is not allowed to use as a basis for tax discrimination: a taxpayers nationality,<sup>551</sup> a permanent establishment maintained by an foreign with the domestic territory,<sup>552</sup> payment of interest, royalties and other consideration to a recipient abroad<sup>553</sup> and the holding by a non – resident of shares in a resident enterprise.<sup>554</sup> Article 24 (5) is of significant here which contain the following provision:

“Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.”

The object and purpose of Article 24(5) is to ensure that South Africa does not impose different tax rates on South Africa resident corporations, partnerships or other entities ultimately owned or controlled by other contracting States residents in contrast with those imposed on South African resident companies ultimately owned or controlled by South African residents on the ground that the owner or controller is resident in the other contracting States.<sup>555</sup> This provision is aimed at prohibiting discrimination taxation on enterprises, not persons owning or controlling the capital.<sup>556</sup>

According to section 108 of the Income Tax Act, when a DTA has been domesticated via legislation it become part of South Africa domestic statutory law. The purpose of Article 24 is to prevent discrimination against persons or entities as mentioned in Article 24 on the

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<sup>551</sup>OECD MTC. 2010. Condensed Version, Paris: Article 24 (1) and (2).

<sup>552</sup>*Ibid* Commentary on Article 24 (3), p 339 -349.

<sup>553</sup>*Ibid* Article 24 (4).

<sup>554</sup>*Ibid* Commentary on Article 24 (5), p 350 -352; Vogel, K. (1997).Double Taxation Conventions Kluwer Law International, p 43, marginal note 79.

<sup>555</sup>OECD MTC. 2010. Condensed Version, Paris: Commentary on Article 24 (5), p 350 - 352.

<sup>556</sup>*Ibid* Commentary on Article 24 (5),p 350:77.

grounds referred to in that article. The prevention, mitigation or discontinuation of the levying of tax in respect of the same income, profits or gains or in respect of the same donation in both contracting States is not the purpose of Article 24. Therefore, to the extent that the provisions of Article 24 are included in a South African DTA, they do not get any legal authority from section 108 of the Income Tax Act. Thus, the provisions of Article 24 will not have any legal consequence as they are not enacted in terms of section 108 of the Income Tax Act.<sup>557</sup>

A selected few South African and United Kingdom tax cases in which Article 24 (5) is analyzed with a view to drawing a conclusion regarding South Africa interpretation approach to Article 24 (5).

In *ITC 1364*<sup>558</sup> the tax court was requested to determine whether sums that the taxpayer paid to his wife for maintenance constitutes double taxation and is in conflict with the provisions of Article 23 (1) of the DTA (the non – discrimination clause) between United Kingdom and South Africa. The court held that taxpayer cannot satisfied that the tax responsibility with which he is burdened is more onerous than the taxation and connected requirements to with nationals in South Africa, in the same circumstances, may be subjected. Any other South African national, divorced after 1962, may not deduct the maintenance payments in order to establish his income.<sup>559</sup> The court also finds that as far as Article 23 (1) is concerned, it has no application.

In *ITC 1544*<sup>560</sup> the court had to decide whether the non – discrimination article in the DTA between South Africa and the United Kingdom was been drifted when South Africa imposes non-resident shareholders tax ('NRST') on dividends received by a non-South Africa company. The court concluded that Article 25 of the DTA (the non – discrimination clause) is a special provision appearing later in the DTA and in the event of conflict with previous articles of a general nature it should prevail.<sup>561</sup>

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<sup>557</sup>Solomon, P & Boltar, J. (2010). 'Non-discrimination': AP de Koker & Emil Brincker, *Silke on International Tax*, par 37.1.

<sup>558</sup>(1980) 45 SATC 23.

<sup>559</sup>*Ibid* p 26.

<sup>560</sup>(1992) 54 SATC 456 (T).

<sup>561</sup>*Ibid* p 462.



In *Boake Allen Limited v Revenue and Customs Commissioners*<sup>562</sup> the court had to consider whether section 247 of the Income and Corporation Taxes Act 1988 (“ICTA 1988”) was in contrary with the non – discrimination clause contained in the DTA entered into by the United Kingdom with the United States and Japan. The Court held that section 247 of ICTA 1988 did not discriminate on the basis that the capital of a subsidiary was controlled by a non-resident company. A group election is a joint decision by two entities paying and receiving dividends that one rather than the other will be liable for ACT. This concept could not be applied meaningfully when one of the entities was not liable for ACT at all.<sup>563</sup> The court held that it was not possible to dissociate the positions of parent and subsidiary as the High Court and the Court of Appeal had sought to do. To allow an election by a group with a US parent would not be to give a relief available to a group with a UK parent. Rather, it would not be an election as to who was liable for ACT but as to whether the group should pay ACT at all.<sup>564</sup>

Furthermore, Boake Allen had been denied the right to make a group election not because it was under foreign control but because section 247 of ICTA 1988 could not be applied to cases where the parent company was not liable to ACT.<sup>565</sup> The court further held that on a fair reading of the 1988 Act as a whole, ACT was not within the ambit of section 788 of the ICTA 1988 and even so if discrimination had been found to have occurred, the non-discrimination articles of the DTAs would not have been given effect by English law.<sup>566</sup>

It will be recalled that in *HMRC v FCE Bank PLC* (‘FCE’)<sup>567</sup> both FCE and Ford Motor Company Limited (‘FMCL’) were resident corporations of the UK and subsidiaries of Ford Motor Corporation (‘FMC’) a US resident company. The group relief of trading losses was denied by HMRC on the basis that they were not members of the same group because their holding parent corporation was not a resident corporation in the UK. FCE and FMCL argued that the non-discrimination article in the US / UK DTA allows for group relief to be available

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<sup>562</sup>[2007] UKHL 25, [2007] 1 WLR 1386.

<sup>563</sup>*Ibid* p 707G-708B.

<sup>564</sup>(2007) UKHL p 25, (2007) 1 WLR p 708E-F.

<sup>565</sup>(2007) 1 WLR p 709D.

<sup>566</sup>(2007) UKHL p 25, (2007) 1 WLR p 717D - E.

<sup>567</sup>(2012) EWCA Court of Appeal (Civil Division) p 1290.



in these circumstances because such discrimination was prohibited by the non-discrimination article in the DTA. The HMRC argued that the difference in treatment was not based on the residence of FMC but because both FCE and FMCL was not subject to corporation tax in the UK. The court held that the difference in treatment was by virtue of the fact of FMC US resident corporation rather than because FMC was not subject to UK corporation tax. The court further held that both FCE and FMCL could rely on the non – discrimination article in the DTA.

In a another UK case of *Felixstone Dock and Railway Company and Others v Commissioners for HMRC*<sup>568</sup> the applicants were UK residents companies in the Hutchison Whampoa Group, whose ultimate parent, Hutchison Whampoa Group was resident in Hong Kong. The referral arises out of claims for group relief by the applicants in respect of losses made by one member of the group Hutchison 3G UK Limited. In order for the group relief to be available there must exist a ‘link company’ which is both a member of the consortium and a member of a group of companies. In the present case the applicants argued that Hutchison 3G UK Investments Sarl, a company resident in Luxembourg, was such a company on the basis that it was a member of the consortium owning, through an intermediate UK resident holding company and was in addition a member of a group of companies which included the applicants. In this case the court had to consider three questions. The relevant one was to what extent does Article 26 of the UK / Luxembourg DTA (the non – discrimination article) impact upon the applicants claims for group relief? The court answer the question by ruling that the inability to surrender its losses to the applicants arose solely on the ground that Hutchison 3G UK Limited was indirectly owned by Hutchison 3G UK Investments Sarl which was resident in Luxembourg and a UK resident corporation.

The OECD MTC Commentary on Article 24 (5)<sup>569</sup> declares that a provision which exempts a resident subsidiary from tax where its holding company is a resident, but not when the holding company is a non – resident, is not discriminatory.<sup>570</sup> It determines:

“... it is not because the capital of the resident company is owned or controlled by non – residents that it is treated differently; it is because it makes distributions to

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<sup>568</sup>(2011) UKUT 420 (TCC).

<sup>569</sup>OECD MTC. 2010. Condensed Version, Paris: Commentary on Article 24(5) p 350:78.

<sup>570</sup>*Ibid.*

companies that, under the provisions of the treaty, cannot be subjected to the same tax when they re-distribute the dividends received from that resident company”.<sup>571</sup>

The OECD MTC Commentary is in agreement with the decision in *Boake Allen Limited* case. South Africa is an observer member of the OECD.<sup>572</sup> However, it is bound by the decision of *SIR v Downing* to take note of the OECD MTC Commentaries.<sup>573</sup> Additionally, it is also bound to respect international law, such as the provisions of the OECD MTC and DTAs.<sup>574</sup> The OECD MTC Commentary may therefore be used to interpret Article 24 (5) of South Africa DTAs in as far as this relates to a South African resident company. It can therefore be argued that a South African resident company is denied the benefits not because its shareholder is a non – resident company, but to prevent that South Africa loses out on taxing the group.

It is also suggested that Article 24 (non-discrimination provision) in a South African DTA entered into by the national executive and approved by Parliament is binding on South Africa under international law.<sup>575</sup> The difficulty, however, is that in terms of s 231(4) of the Constitution, such a DTA is only incorporated into South African domestic law if and when “it is enacted into law by national legislation”. DTAs are normally so enacted into law by proclamation in terms of section 108(2) of the ITA. But this section only provides for DTAs of the kind as anticipated in section 108(1) to be enacted into law in this way. “...Once a treaty (DTA) is accepted by parliament” as contemplated in section 231 of the Constitution and is published in the government gazette, it forms part of the domestic law under s 108(2). The non-discrimination article therefore forms part of South African domestic law. This means that, if and to the extent that a South Africa DTA goes beyond the parameters of section 108(1), it may not be validly enacted into law by proclamation under section 108(2).

## 5.8 Concluding remarks

South Africa DTAs are incorporated into South African domestic law by way of statutory enactment in accordance with the dualist approach to public international law. Although a

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<sup>571</sup>*Ibid.*

<sup>572</sup>Olivier, L. & Honiball, M. (2011). *International Tax A South African Perspective*, p 270.

<sup>573</sup>1974 (4) 518 (A.D) 522 H – 523A).

<sup>574</sup>Section 232 Constitution of the Republic of South Africa, 1996.

<sup>575</sup>*Ibid* section 231 (1), (2), (3).

DTAs forms part of the Income Tax Act after enactment and publication in the government gazette, it is not yet well-founded whether a South African DTA outranks the other provisions of the Income Tax Act in a case of conflict. South Africa case law on the irreconcilable conflict between DTAs and the Income Tax Act and the interpretation of DTA indicated that there are three major opinions. According to the first opinion the Income Tax Act must conquer.<sup>576</sup> According to the second opinion, a DTA modifies domestic law and will apply in preference to domestic law in the case of conflict.<sup>577</sup> The third opinion is that the DTA and Income Tax Act rank equally and any conflict must be resolved by the application of the principles of domestic statutory interpretation (e.g the common law principles).<sup>578</sup>

The thesis is of the view that the third opinion is superior; it is however acknowledged that the second opinion will probably be applied in South Africa, as this was a tax judgment by the Supreme Court of Appeal. South Africa DTAs may modify and in some instances, override the Income Tax Act to the extent that this is necessary in order to achieve their objectives (as stated in section 108 of the Income Tax Act). Furthermore, it is suggested that once a South Africa DTA is acknowledged by parliament as contemplated in the Constitution<sup>579</sup> and is published in the Government Gazette, it forms part of the Income Tax Act.<sup>580</sup> Therefore the non-discrimination article of South African DTAs will forms part of South African domestic statutory law.

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<sup>576</sup>AM Moola Group Ltd and Others v C: SARS and Others 2003 (6) SA 244 (SCA), 2003 65 SATC 414 (SCA); Olivier, L. & Honiball, M. (2011). International Tax A South African Perspective, p 317.

<sup>577</sup>Commissioner, South African Revenue Services v Tradehold Ltd 2012 3 All SA 15 (SCA); Brincker, E. (2010). 'The Conclusion and Force of Double Taxation Agreements': AP de Koker & Emil Brincker, Silke on International Tax, par 12.7.1.

<sup>578</sup>Per Ngcobo CJ, delivering the minority judgment in Glenister v President of the Republic of South Africa 2011 (3) SA 347 (CC); Commissioner, South African Revenue Service v Van Kets 2012 (3) SA 399 (WCC).

<sup>579</sup>Section 231 of the Constitution of the Republic of South Africa, 1996.

<sup>580</sup>Section 108 (2) of Act No. 58 of 1962.

## 6 CHAPTER 6: CONCLUSIONS

The mission of this mini-dissertation was to find an answer to the question of whether South African DTAs can be interpreted under the VCLT which codified the principles of customary international law in the area of interpretation of treaties. The examination of selected South African case laws demonstrated that South Africa DTAs can be interpreted under VCLT even when South Africa is not a signatory to the VCLT.<sup>581</sup>

The distinctive characteristic of a DTA is that it involves two independent contracting States which usually have diverse legal systems, legal customs, tax structures and standards of judicial interpretation. Each contracting State will approach DTA negotiations with a view to benefit itself and without any wisdom of sympathy to citizens and corporations of the other contracting State.

Most of South Africa DTAs are based on the OECD MTC model structure. They follow a similar structure in terms of their application, distributive rules, evasion and anti – avoidance prevention measures, and administrative and procedural matters. Most of the distributive rules in South Africa DTAs are scheduler in nature.

In South Africa the negotiation of DTAs falls within the prerogative of the national executive, whereas the ratification and the incorporation of DTAs into South Africa domestic law is within the mandate of Parliament. The approval of a DTA by the resolution of Parliament does not amount to its enactment into South Africa law. Under the South African Constitution, the actions of the executive in negotiating and signing of DTA do not result in a binding DTA. Legislative action is required before a DTA can bind South Africa.

The status of a DTA in South Africa is determined by section 231 of the Constitution of the Republic of South Africa and section 108(1) of the Income Tax Act. Section 108(2) of the Income Tax Act on the other hand further provides that once a DTA is approved by Parliament and published in the government gazette; such an agreement will assume equal status with the domestic tax laws. In the event of any ambiguity or conflict between the DTA and the provisions of the Income Tax Act, the DTA must take preference and its provisions be given effect.<sup>582</sup>

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<sup>581</sup>Secretary for Inland Revenue v Downing 1975 (4) SA 518 (A); 37 SATC 249; Commissioner, South African Revenue Services v Tradehold Ltd 2012 3 All SA 15 (SCA); 74 SATC 263.

<sup>582</sup>SIR v Downing 1975 (4) SA 518(A) 523 A; 37 SATC 255.

In order for DTAs to serve their functions properly, the two contracting States need to adopt consistent DTA interpretations. Inconsistent interpretation can lead to either double taxation or double exemption. For a start, DTAs are part of the international public law regime and have to be interpreted accordingly. Therefore, principles of treaty interpretation as laid down in the VCLT<sup>583</sup> are to be heeded as they form part of customary international law. They also form part of South Africa law through the Constitution.<sup>584</sup>

Apart from VCLT treaty interpretation principles, most South African DTAs contain an article 3 (2). The purpose of article 3(2) is sometimes confusing. For some, it assembles the idea of authority of interpretation based on domestic law in order to determine the true meaning of undefined terms in a DTA, while for others there is no such authority but a lesser right to use domestic meaning only in disputes where no other solution that can be derived from the context of the DTA provisions. Despite these contrasting observations, it can be contended that the genuinely, everyday differences are very little. As there is no disagreement about the fact that a meaning from the DTA context takes precedence and, if it can be found, does not take any inconsistent meaning of the domestic law into account.

Ratification of DTAs means it become part of South Africa domestic statutory legislation. Because a DTA becomes part of the domestic law of the Republic of South Africa, the ordinary rules of interpretation of statutes should be applicable if there is a conflict between the DTA provisions and the Income Tax Act provisions. However, it can be argued that domestic rules of interpretation of statutes should not be strictly adhered to, as DTAs are bilateral international agreement and its international nature should be considered by the courts in establishing the intention of the contracting States. This should be at least the case for South Africa even if it has not ratified the VCLT.

Thus, the interpretation of DTAs must not diverge whatsoever from the treaty interpretation principles in Articles 31 to 33 of the VCLT as most of South African DTAs are based on the OECD MTC. This is beside the fact that a South African DTA must be interpreted in good faith and in accordance with the ordinary meanings given to the terms of the DTA in their context and in the light of their object and purpose.

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<sup>583</sup>Articles 31 and 32 of the VCLT.

<sup>584</sup>Sections 232 and 233 of the Constitution, 1996.

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- ❖ Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Income and on Capital Gains. Government Gazette No. 24335 dd 31/01/2003.
- ❖ Organisation for Economic Co-operation and Development. (July 2010). Model Tax Convention on Income and on Capital: Condensed Version (Loose leaf) Paris. OECD.
- ❖ OECD (2010) Model Tax Convention on Income and on Capital. Condensed Version: Paris. [www.oecd.org/dataoecd/14/32/41147804.pdf](http://www.oecd.org/dataoecd/14/32/41147804.pdf)
- ❖ The Vienna Convention on the Law of Treaties. (23 May 1969).

## **RULES**

- ❖ Rules 306-308 of the National Assembly 7<sup>th</sup> edition, June 2011.