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AN EVALUTION OF TAX HAVENS AS A MODE OF INDIVIDUAL AND CORPORATE TAX EVASION AND SOUTH AFRICA'S POSITION REGARDING THE OECD'S RECOMMENDATIONS

by

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Submitted in fulfilment of the requirements for the degree

(LLM MERCENTILE LAW)

In the Faculty of Law,
University of Pretoria

Date
(OCTOBER 2016)

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ACKNOWLEDGMENTS

Firstly, I would like to thank God for giving me the strength to get this far. I would also want to thank my supervisor (Mrs Carika Fritz) for her guidance, hard work and patience with me throughout this period.

Secondly, to my bosses (Mr JN Lebea & Mr MC Lebea) thank you for giving me time off to ensure that I complete my Masters.

Thirdly, to my family and friends thank you for the love, support and encouragement during this long journey. To my beautiful baby girl and my one and only sister, you continue to motivate me.

Lastly, to my mommy thank you for being my motivation and inspiration throughout this period. YOU ARE THE BEST!!!!!!!!

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ABSTRACT

Tax haven jurisdictions have over the years been used and abused by individuals and companies to further their own interests or beneficial owner's interests (e.g. Shareholders and beneficiaries in a trust) through investments made in these jurisdictions. These jurisdictions are largely used as a channel for tax evasion and to conceal criminal activities such as money laundering. Due to the growth in international trade and globalisation, it has become important to ensure that individuals and corporations are prevented from participating in harmful tax practices in an attempt to evade tax. To minimise investments in tax haven jurisdiction which are solely done to evade tax, the Organisation for Economic Development and Cooperation ("OECD") set out some recommendations which are applicable on an international spectrum to combat this form of tax evasion. This dissertation addresses whether South Africa is complying with the recommendations of the OECD against investments in tax haven jurisdictions for purposes of evading tax. The importance of this study is to analyse South Africa's compliance with the recommendations and to ensure that the standards currently in place to combat tax evasion are sufficient and to lay down recommendations that assist in ensuring transparency. By complying with international standards more particularly Bank transparency through Multinational agreements that enable signatory country to disclose information requested for tax matters. Should the recommendations by the OECD be fully implemented, it will enable South Africa to tax residents on their world-wide income, thereby ensuring that there are sufficient funds to cater for the poor and middle class people and enable economic growth within the country. In order to analyse South Africa's compliance with the recommendations, the dissertation evaluate some of the anti-tax avoidance provisions in the Income Tax Act which are consistent with the recommendations of the OECD as well as some treaties entered into by South Africa.

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CHAPTER 1

1. OVERVIEW

1.1. Introduction

Due to the increase of cross border transactions, globalisation and advanced technology, companies and individuals are increasingly developing global strategies to avoid tax and maximise profits.[1] These transactions, although beneficial to an individual or companies,[2] have a negative impact on the total revenue collection in a country.[3] Tax havens developed in the 1950's British system which granted independent economic governance to protectorates such as the Channel Island, which then became an easy way for people to protect their monies by deferring income from high tax jurisdiction to lower tax jurisdictions that levy zero or minimum tax.[4] The recent fallout in the media early this year (2016) leaked documents showing practices that benefit the rich and encourage money laundering as well as other form of corruption which systemically affects a country's economic development such as South Africa.[5] The Organisation for Economic Development and Cooperation ("OECD")[6] divides the jurisdictions charging zero or minimum taxation into two, namely: "tax haven

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[1] Schneider J *The complete guide to offshore money havens* (2001) 193. See also Oguttu AW "A critique on the OECD Campaign against tax havens: Has it been successful? A South African perspective" (2010) 172. Botha P *An analysis of low tax jurisdictions as a means of increasing foreign direct investments from a South African point of view* (2010) 21.

[2] Section 1 of the Companies Act 71 of 2008, as amended, defines a company as juristic person incorporated in terms of the Companies Act or the Close Corporations Act. A juristic person is defined as an entity that has its own legal entity that is separate and distinct from its owners. Companies enjoy most of the rights and responsibilities that an individual possesses; that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay its own debts.

[3] Oguttu AW (2010) 172.

[4] Sanni A "Sovereign rights of tax havens and the change of harmful tax competition" (2011) 14. See also Palan R *et al Tax havens: How globalization really works* (2010)17.

[5] Visser A "New reporting standards will make Panama papers expose more frequently" (2016) 5

[6] The OECD is a forum where governments can work together to share experiences and seek solutions to common problems. These governments work hand in hand to understand factors that drive the economy, social and economic change. It also sets international standards on a wide range of things, from agriculture and tax to the safety of chemicals. See OECD "mission" available at http://bit.ly/1mVNYSO (accessed 16 May 2016).

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jurisdiction" and "harmful preferential tax regimes".[7] Tax haven jurisdictions are made up of characteristics such as high level of secrecy in their banking systems and commercial sectors, they encompass a lack of transparency and a lack of effective exchange of information with other governments concerning their benefits.[8] Harmful preferential regimes on the other hand have the same characteristics as tax haven jurisdictions, however, in addition to those characteristics, harmful preferential regimes are also ring fenced.

This dissertation evaluates the extent to which South Africa conforms to the recommendations by the OECD to curb harmful tax practices despite the fact that South Africa is a non-member. South Africa has an active relationship with the OECD and participates in most of the organisation's initiatives. In so doing, this dissertation firstly identifies and evaluates the benefits which taxpayers receive from tax havens and harmful preferential regimes as well as the disadvantages towards the economy. This is done by identifying some of the transactions that individuals and companies enter into which may be seen as an investment in a tax haven jurisdiction. Secondly, this dissertation analyses the 3 groups of recommendations and guidelines outlined in the OECD 1998 report on harmful tax competition. In so doing, it looks into how non-member countries such as South Africa can adopt those recommendations in order to effectively manage and to pierce the shield of secrecy for companies and individuals. Thirdly, it analyses the progress by the Global Forum with regards to the automatic exchange of information.[9] Fourthly, this dissertation also stipulates the factors that one should take into consideration when identifying tax havens and harmful

[7] OECD "Harmful Tax Competition: An emerging global issue" (1998) available at http://bit.ly/1pErI4a (accessed 15 May 2016) 20-21. Harmful preferential regimes are defined in the OECD 1998 Report as those regimes which provide a favourable location for holding passive investments or for booking paper profits. In most circumstances, these regimes are used as a conduit for routing capital flows across borders. They are defined by making reference to their characteristics. Namely: *(a)* the regime imposes a low or zero effective tax rate on the relevant income; *(b)* the regime is "ring-fenced"; *(c)* the operation of the regime is non-transparent; *(d)* the jurisdiction operating the regime does not effectively exchange information with other countries.
[8] Caccamise WC Jr. "U.S. Countermeasures against tax haven countries" (1988) 557.See also Sanni A (2011) 17.
[9] Oguttu AW (2010) 176. Also see OECD "Global forum for transparency and exchange of information for tax purposes: progress report" (2014) available at http://bit.ly/1AvOS3v (accessed 30 July 2016).

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preferential regimes. Lastly, it analyses the extent to which South Africa has aligned itself to the recommendations of the OECD.

1.2. Problem Statement

Individuals and companies[10] are constantly investing their monies in off-shore accounts which charge very little or no tax at all.[11] This has a substantial impact on the total revenue collection of a country. Tax havens provide a willing sanctuary for tax evasion, as they have poor financial regulations and offer an opportunity for money laundering by off-shore residents.[12] Even though some governments benefit from the existence of tax havens, others experience losses. The lack of transparency is a problem that can be addressed by following the 3 groups of recommendations outlined in the OECD 1998 report. The recommendations have been classed into 3 groups. The 3 groups require that countries should firstly, improve and or implement domestic legislation which aims to curb harmful preferential regimes; secondly, countries should consider renegotiating tax treaties with jurisdictions offering harmful tax competitions; and lastly, countries should intensify international co-operation between both member countries and non-member countries of the OECD. This will effectively encourage countries to share information for tax purposes in order to minimise tax evasion and maximise the total revenue collection within a country.[13]

I opine that the world's economy is affected by these offshore investments made in tax haven jurisdictions or harmful preferential regimes which have an effect in widening the gap of inequality amongst the rich and the middle class individuals.

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[10] Article 26 of the OECD Model Tax convention on income and on capital defines the term "company" as a body corporate or any entity that is treated as a body corporate or any entity that is treated as a boy corporate for tax purposes. See OECD "Articles of the model convention with respect to taxes on income and on capital" (2003) available at http://bit.ly/2dG6t1G (accessed 18 September 2016) 7.

[11] Oguttu (2010) 173.

[12] Action Aid "How tax havens plunder the poor" United Kingdom (2013) available at http://bit.ly/2dRsQiV (accessed 22 May 2016) 5. See also Sanni A (2011) 17. See also Ogley A *Tolly's tax havens* (1990) 8.

[13] Margolis A "Tax havens" (2009) 13 where it is stated that Government has increasingly been calling for more transparency in tax haven jurisdictions.

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The main reasons for my observations are that normally, tax havens are attractive to rich individuals and big companies that are able to hide exorbitant amounts of money in Offshore Financial Centre (OFC) or tax havens.[14]

1.3. Purpose of the Dissertation

The purpose of this research is to determine the extent to which South Africa is complying with the OECD recommendations to curb harmful tax practices. In so doing, the research identifies and analyses the domestic provisions aimed at protecting the economy against harmful preferential regimes. It also looks as tax treaties that South Africa has entered or renegotiated in order to prevent treaty abuse. Lastly, it analyses whether South Africa is effectively co-operating with the international standards in the OECD report.

1.4. Research Objectives

This dissertation has the following objectives:

1. To evaluate and analyse the extent to which South Africa complies with the three groups of recommendations outlined in the OECD report to curb harmful tax practices; and
2. To analyse and evaluate the sufficiency of South Africa's domestic law in curbing harmful tax practices.

[14] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 15 and 17. See also White D "Tax havens: Low tax or no tax? Identifying harmful Tax Practices is only the beginning" (2009)10. See also Visser A (2016) 5.

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1.5. Importance and benefits of the proposed study

This research will analyse the measures adopted by the OECD in the 1998 report which aims to discourage the spread of tax havens and harmful preferential regimes and to encourage the strengthening of and improvement of tax policies on an international level. The OECD report also aims at ensuring complete transparency amongst signatory countries.[15] The reporting standards will, amongst other things, ensure that the South African Revenue Service ("SARS") is informed of the financial affairs of signatory countries worldwide. Countries that signed the declaration of automatic exchange of information have a duty to exchange information of individuals and companies that have invested money in a tax haven jurisdiction for purposes of evading the domestic tax. The Panama papers have recently revealed ways in which the rich hide their monies in tax havens.[16] The contents of the Panama papers are discussed in other chapters of the dissertations as and when they become relevant to a specific topic. The newly adopted measures by the OECD aimed at complete transparency between countries with a signatory to exchange of information will enable the country to collect additional revenue that will assist the economic growth and also bridge the gap between the rich and poor.

1.6. Limitations and Assumptions

This research is limited to the extent to which South Africa's complies with the OECD's recommendations in order curb harmful tax practices. The research focuses on current practical issues revolving around tax havens. The historical aspects will only go as far as the 1998 OECD Report on harmful tax practices in

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[15] Giles WH "Tax havens" (1966) 20. See also Visser A (2016) 5. South Africa is one of the countries that have recently adhered to the recommendations set out by the OECD including the Declaration on Automatic Exchange of Information in Tax Matters which enable the accessibility of information which was previously privileged, see OECD "Declaration on automatic exchange of information in tax matters" (2014) Report available at http://bit.ly/2dBTmMG (accessed 29 October 2016) 2.
[16] Visser A (2016) 5.

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that it is the subject matter of this dissertation. Other possible issues that will be covered are the OECD recommendations and the measures adopted in 2015 aimed at ensuring transparency in data availability. This dissertation will also analyse how the global forum[17] on transparency and the exchange of information in implementing the recommendations. The researcher will use existing data based on textbooks, articles, dissertations and thesis. Due to a dearth / scarcity of case law dealing with tax havens, this dissertation focuses mostly on literature on this topic.

1.7. Definition of key terms

1.7.1. **Tax havens**: the term tax haven is associated with a jurisdiction that levy nil or minimum taxes.[18] These countries also have some characteristics of lack of transparency, bank secrecy and the lack of information sharing, and require little or no economic activity for an entity to obtain legal status.[19]

1.7.2. **Tax Avoidance**: it is a legal method of reducing a taxpayer's liability by using the provisions of the fiscal legislation to his or her advantage.[20]

In *IRC v Duke of Westminster*[21] it was stated that: "Every man is entitled, if he can, to order his affairs so that the tax attracting under the appropriate Act is less than otherwise would be."

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[17] The global forum was established by the OECD as a forum which would carry out the work relating to the transparency and the exchange of information. The Global forum consist of 122-member jurisdiction and EU together with 14 observers. Essentially, it consists of all the G20, OECD member countries, International financial centre as well as many developing countries. South Africa is the current Chair for the Global Forum.
[18] Oguttu AW (2010) 173.
[19] Sanni A (2011) 17.
[20] Croome BJ *et al Tax law: An introduction* (2013) 487.
[21] (1936) 19 TC 490 at 520.

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1.7.3. **Tax Evasion**: the reduction of a taxpayer's tax liability by illegal means such as the non-declaration of income that is properly subject to tax or by claiming deduction to which the taxpayer is not entitled.[22]

The OECD has defined "tax evasion" as encompassing "illegal arrangements or by means of which liability to tax is hidden or ignored," that is, arrangements in which "the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities".[23]

1.7.4. **Off-shore Banking Centre**: McCarty defines the term off-shore banking centres as:

> "cities, areas, or countries which have been made a conscious effort to attract … non-resident foreign currency-denominated business… by adopting a flexible attitude where taxes…and regulations are concerned."[24]

1.7.5. **Ring fencing regimes:** these are regimes which explicitly or implicitly excludes resident taxpayers from taking advantage of its benefits or where enterprises which benefit from the regime are expressly or implicitly prohibited from operating in the domestic market.[25]

1.7.6. **Treaty Shopping:** For a person to be entitled a treaty benefit, such person needs to firstly be a resident of one of the contracting state as defined in Article of the OECD Model Tax Convention. However, when a non-resident to the contracting states attempts to enter into arrangements in order to obtain benefits that a tax treaty grants to its residents within the

[22] Croome BJ (2013) 487. See also Satumba R *An analysis of the general anti-avoidance rule in South Africa and a comparison with foreign anti-avoidance provision* (2011) 16.
[23]OECD 1998 Report available at http://bit.ly/1pErI4a 39. See also SARS discussion on tax avoidance and the OECD, *International Tax Terms for the Participants in the OECD Programme of Cooperation with Non-OECD Economies* available at http://bit.ly/2eb8y5n (accessed 20 September 2016) 2-3.
[24] Quoted in Antoine RMB *Confidentiality in offshore financial law* (2014) 8.
[25] OECD 1998 Report (accessed 15 May 2016) 27.

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contracting states, such arrangements are generally referred to as "treaty shopping."[26] Treaty shopping involves persons that are resident in a third State attempting to access benefits indirectly through arrangements from treaties entered into by two other contracting states.[27]

1.8. Research Design and Methods

This research will be evaluative in nature. Relevant information will be collected from South African sources together with international sources in the form of articles, textbooks, dissertations and thesis. The researcher will do an analysis on existing data and give a general overview of the current situation revolving around tax havens together with the recommendations that have been put in place and whether they will be sufficient to combat this tax haven crisis.

The information that will be collected will mainly revolve around the OECD and the 1998 recommendations and guidelines to curb harmful tax practices, how they will be implemented and whether they will be sufficient. The research will also give a brief overview on the extent to which South Africa intends to comply with the OECD's recommendations.

1.9. Overview of chapters

Chapter 1 of this dissertation deals with the grounds of the research, problem statement and the purpose of the study.

Chapter 2 provides an overview of what constitutes a tax haven jurisdiction, how it contributes towards tax evasion and avoidance. It will also deal with how a tax haven jurisdiction can be identified as a harmful preferential regime. This is relevant in

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[26] OECD "Preventing the granting of treaty benefits in inappropriate circumstance" (2014) report available at http://bit.ly/1iUSW3R (accessed 29 October 2016) 17. See also Grady GK "Income Tax Treaty Shopping: An Overview of Prevention Technique" (1983) 627.
[27] OECD 2015 Report available at http://bit.ly/1iUSW3R (accessed 29 October 2014) 17.

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determining the protective measures that countries need to exact in preventing the harmful tax competitions that the abovementioned regimes have towards the economy.

Chapter 3 will provide advantages and disadvantages of tax haven jurisdictions by analysing how it can be advantageous towards an individual or corporation that make investments in a tax haven jurisdiction and how one can benefit from such investment. I will also analyse how these investments can be disadvantageous towards the world economy, as well as the potential effects it may have in creating a financial gap between the rich and the poor.

Chapter 4 this chapter analyses the recommendations outlined in the OECD 1998 report and it will also analyse the extent to which South Africa complies with these recommendations.

Chapter 5 this chapter will conclude my research findings and give recommendations regarding South Africa's compliance with the OECD's 1998 recommendations and guidelines.

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CHAPTER 2

2. TAX HAVENS

2.1. Introduction

A tax haven jurisdiction is a jurisdiction that allows an individual or companies to evade taxes in various ways. Corporate tax haven users may utilise tax haven jurisdictions to evade taxes within their country of residence through holding or shell companies,[1] making offshore banking and investments, having shipping companies, having captive insurance and manufacturing in tax free zones. Individuals, on the other hand, may also make use of tax haven jurisdictions to evade tax directly through emigration or indirectly through family trusts or holding companies. This chapter analyses the characteristics of a tax haven jurisdictions and how tax haven jurisdictions contribute towards offshore tax evasion and avoidance. It will deal with the recent reports by the Panama papers which exposed how the rich and famous utilise tax haven. In so doing, it will also deal with factors that can be used to identify a tax haven jurisdiction as a harmful preferential regime.

2.2. What constitutes a tax haven jurisdiction

A tax haven jurisdiction offers countries with an option to use non tax initiatives to attract activities in the financial and other service sector which enable individuals and companies to reduce the amount of domestic tax base or corporate tax that they would have been liable for onshore. Foreign investors are able to benefit from such jurisdictions in that they are not taxed at all or the tax bases within that jurisdiction is minimal.[2] The characteristics of these jurisdictions entail the following:

[1] Holding Companies or Shell companies can be defined as corporations which have no substantial active, business operations or significant assets. These companies are solely established to obscure the identity of their beneficial owners and controllers and they constitute a substantial proportion of the corporate vehicles established in an OFC. In this regard, see OECD "Behind the corporate veil using corporate entities for illicit purposes" (2001) available at http://bit.ly/2f1eOzf (accessed 24 October 2016) 79. Crawley T *Using tax havens successfully* (1978) 158 also see Starchild A *Tax havens for corporations* (1979) 77.
[2] Sanni A (2011) 17. See also Oguttu AW (2010) 172. See also Ogley A (1990) 3.

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lack of transparency, bank secrecy, lack of information sharing[3], and require little or no economic activity for an entity to obtain legal status.[4] However, it has been criticised by some writers[5] that there is generally no internationally accepted definition of what constitutes a tax haven jurisdiction.[6] When looking into the characteristics of a tax haven jurisdiction by analysing it broadly, it would encompass almost every country in that a country such as the Netherlands is considered to have tax haven characteristics due to the fact that it allows firms to reduce taxes on dividends and capital gains from subsidiaries and have a wide range of treaties that enable it to reduce its tax.[7] This interpretation would not give a precise meaning of what would constitute a tax haven jurisdiction.[8] Therefore, there seems to be no clear and precise meaning of what constitutes a tax haven jurisdiction. In this regard, it is of vital importance to identify tax havens that constitute a harmful tax competition. Instead of having a precise and specific

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[3] These characteristics enhance secrecy with other Jurisdictions concerning the benefits that taxpayers derive from tax haven jurisdictions. Banking secrecy restricts access to banking information for tax purposes. This provision in banking sectors enables taxpayers to open secret accounts wherein banks are unable to identify the beneficial owners of the accounts. Provisions like these attract tax evaders. Article 47 of the Swiss Banking Law states, *inter alia:* "Any . . .official, employee, examiner, or assistant to an examiner of a bank, any member of the Banking Commission, official or employee of the secretariat attached to it who intentionally violates . . .the professional secret or anybody who persuades, or tries to persuade, the above to do so shall be punished by a fine not exceeding fr.20,000 or six months in jail or both. If such an act is due to negligence, the penalty shall be a fine not exceeding fr. 10,000."

[4] Sanni A (2011) 17. See also Oguttu AW (2010) 173.

[5] Writers such as Sanni A and Oguttu have criticised that this concept has no precise definition and that other lists have been developed through researchers.

[6]The term tax haven, Offshore Financial Centre ("OFC"), secrecy jurisdictions as well as uncooperative jurisdictions are used interchangeably to describe the jurisdictions with no tax or minimal tax, secrecy provisions, advantages to non-residents, with the logical aim of attracting individuals and companies to invest in those countries. See also Oguttu AW (2010) 173.

[7] Gravelle GJ "Tax Havens: International Tax Avoidance" (2015) available at http://bit.ly/1fIbIAV (accessed 22 May 2016) 24. See also Palan R *et al* (2010) 68. See also Schneider J *The complete guide to offshore money havens* (1996) 7.

[8] The OECD is also of the view that a tax haven jurisdiction cannot be defined precisely and that it is usually defined by making a distinction between countries with no income tax or minimal income tax see OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 20, see also Oguttu AW (2010) 173. See also Samuels LB "OECD initiative: Harmful tax practices and tax havens" (2001) 235 to 236, see also Blomeyer and Sanz "European initiative on eliminating tax havens and offshore financial transactions and the impact of these constructions on the union's own resources and budget" (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) 35 wherein a distinction is drawn between how the OECD, International Monetary fund and European Parliament define a tax haven jurisdiction or a OFC .

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definition of what constitutes a tax haven jurisdiction, it is commonly applied in a wide sense by drawing a distinction between countries with no income tax or minimal income tax in order to identify the effects that such harmful tax practices have towards the global economy.[9] Palan defines a tax haven jurisdiction as places or countries that have sufficient anatomy to write their own tax, finance, other laws and regulations in a manner that gives preference to foreign investors.[10] These jurisdictions are not only identified by their zero or minimal tax rate. They are amongst other things able to finance their public services without taxing.[11] As a result, these jurisdictions constitute harmful tax competition in that they create an opportunity for non-residents to invest in their countries in order to avoid or evade their domestic tax.[12]

The abovementioned definition appears accurate in the sense that in numerous instances, tax haven jurisdictions have limited activities and in other instances there are no activities at all in such jurisdictions.[13] Tax haven jurisdictions normally draw their capital and production from other countries by providing an attractive investment haven that provides them with banking secrecy.[14] These jurisdictions produce few goods locally and are import dependant.[15] They adopt policies of having low or no tax in order to attract investors both individuals and companies to transfer the skills and resources into their countries.[16]

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[9] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 22.
[10] Palan R et al (2010) 8. South Africa is not regarded as a tax haven jurisdiction. The tax liability of a foreign company in South Africa is depends on whether the foreign company is regarded as a resident or non-resident. In the event that such company is regarded as a South African resident, it will pay tax on its world-wide income. However, if the foreign company is a non-resident, and subject to any applicable Double Tax Agreement (DTA), the foreign company will only be subject to income tax in South Africa on income derived from a source in South Africa and subject to capital gains tax ("CGT") in South Africa on the disposal of immovable property in South Africa or a right or interest in immovable property situated in South Africa; and on the disposal of assets attributable to a permanent establishment ("PE") of the foreign company in South Africa.
[11] OECD 1998 Report available at http://bit.ly/1pErl4a at 20.
[12] OECD 1998 Report available at http://bit.ly/1pErl4a at 20.
[13] Dean SA "Philosopher kings and international tax: A new approach to tax havens, tax flight, and international tax cooperation" (2006) 935. See also OECD 1998 Report available at http://bit.ly/1pErl4a at 20.
[14] Sanni A (2011) 16.
[15] Palan R *et al* (2010) 3.
[16] Oguttu AW (2010) 173. See also Palan R *et al* (2010) 3.

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Based on the aforementioned, it is the researcher's view that these transactions are damaging onshore in that they create a capital outflow into other jurisdictions and thereby damaging the economic growth of a country due to investments in tax havens. Furthermore, the Tax Act does not provide a precise meaning of what constitutes a tax haven, it becomes difficult for one to identify a tax haven jurisdiction. As it appears from the above, a country which does not have an income tax or which charges a minimal tax and or a country which encourages non-residents to make investments in it in exchange for minimal or no tax rates would more likely be a tax haven jurisdiction.

2.3. Categories of tax haven jurisdictions

There are three / four main categories of tax haven jurisdictions, namely:[17]

a) Traditional tax havens with no tax at all such as Bahamas, Bermuda and the Cayman Islands;
b) Havens which impose minimal tax rates such as British Virgin Island, Gibraltar and Montserrat;
c) Havens which receive income tax from domestic sources but exempt all income from foreign sources such as Hong Kong, Liberia and Panama from paying tax; and
d) Countries which allow special privileges such as the Netherlands and Luxembourg, these countries are usually suitable as tax havens only for a limited purpose.

2.4. How tax haven jurisdictions contribute towards off-shore tax evasion and tax avoidance

The terms Off-shore Financial Centre ("OFC"), tax havens as well as secrecy jurisdictions are sometimes used interchangeably to mean one and the same thing

[17] Langer MJ *Foreign tax havens: Choosing the right one* (1973) 21.

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although they each have their own distinct meaning.[18] OFCs are those sectors specialising in non-resident financial transactions such as the Euromarket transactions.[19] OFC can be seen as an extension of a traditional tax haven in that they are aimed at benefiting from tax avoidance and escaped almost all financial supervisions and regulations.[20] Therefore, the OFC is recently being used as a sophisticated or upgraded term for tax havens.[21]

Due to globalisation and the increase in mobility of money, the OFC has promoted the development of capital and financial markets and has encouraged countries to reduce their tax barriers to capital flow and modernise their tax systems to reflect the recent developments.[22] Growth in the multinational company activities contributes massively towards the popularity of offshore tax haven jurisdictions.[23] Tax haven jurisdictions are attractive investment location thus creating a harmful tax competition in jurisdictions with high tax rates.[24] They facilitate the avoidance and evasion of taxes in income earned elsewhere in the world.[25] In their nature, tax havens undermine the regulations and taxation processes of other countries by providing provisions which make it easy for individuals to evade paying tax.[26] Due to the fact that tax havens are characterised by high level of secrecy in their banking and commercial sectors, it makes them attractive for investors to avail themselves to such banking systems which ensure that the banking transactions within that jurisdiction are kept a secret from tax authorities in other jurisdiction.[27] The main problem with OFC is the secrecy or confidentiality principles[28] that are in place and

[18]Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 37. Tax havens, OFC and secrecy jurisdictions are territories that offer favourable tax rates, less regulatory policies and banking and business secrecy to foreign investors. See also Palan R *et al* (2010) 24.
[19] Palan R *et al* (2010) 24. The Euromarket is considered a major finance source for international trade, through the money market, eurocurrency, eurocredit as well as eurobonds. It is used for financing international trade.
[20] Johns RA *Tax havens and offshore finance: A study of transnational economic development* (1983) 43. See also Palan R *et al* (2010) 24.
[21] Antoine RMB (2014) 7.
[22] Sanni A (2011) 16.
[23] Starchild A *Tax havens for international business* (1994) 18.
[24] Hines JR *Do tax havens flourish?* (2004) 12-13.
[25] Palan R *et al* (2010) 9.
[26] Palan R *et al* (2010) 9.
[27] Hines JR *Do tax havens flourish?* (2004) 12-13.
[28]The confidentiality or secrecy provisions between a bank and client covers all customer information about themselves and the accounts they have in that particular bank. This principle

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are abused by individuals and companies to conceal illegal activities.[29] While confidentiality principles may be important in the banking sectors, this principle has the potential to hinder efficient investigation on potential criminal activities, thus making it easy for individuals and corporation to invest in OFC or tax haven jurisdictions in order to evade tax.[30] I opine that although confidentiality principles may provide security for *bona fide* investors, they may also be used to conceal criminal activities done for purposes of evading tax laws. Tax haven jurisdictions can be used to perpetuate criminal activities by wealthy individuals and companies as it makes it easy for these people to hide stolen money, or proceeds from criminal activities in offshore accounts which are within a tax haven jurisdiction in that these jurisdictions are strongly governed by the secrecy provisions.

2.5. Factors to identify tax haven jurisdictions

Considering the nature of tax havens, which are, amongst others, the lack of transparency or secrecy provisions, it is not easy for one to identify clear factors of tax haven jurisdictions and harmful preferential regimes. It is important to note that the global forum has been tasked to monitor and review the implementation of standards of automatic exchange of information. However, in order to identify a tax haven and to be able to implement the standards, it is of paramount importance to distinguish the characteristics that a tax haven or harmful preferential regimes may have. These characteristics are set out in the 1998 OECD's report on Harmful tax competitions as follows:[31]

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is derived from the bank customer relationship. In the case of *Tournier v National Provincial & union Bank England* (1924) 1 KB 461A 592 (CPD) at 596 the court listed a number of exceptions to the confidentiality rule or principle. The exceptions were classified into the following: where disclosure is under compulsion by law; where there is a duty to the public to disclose; where the interests of the bank requires disclosure; and where the disclosure is made through expressed or implied consent of the client.

[29] Antoine RMB (2014) Oxford 20.

[30] Antoine RMB (2014) Oxford 21.

[31] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 22-24 See also Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 35. See also Samuels LB (2001) 236. See also Ogley A (1990) 5-8.

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a) These are jurisdictions imposing no tax or minimal taxes in that they offer non-residents an option to escape tax in their countries by offering an investment opportunity in an offshore haven;

b) They comprise a lack of effective exchange of information due to the laws or administrative practice under which business and individuals can benefit from strict secrecy rules. This characteristic makes it easy for individuals or companies to successfully evade paying tax, perform criminal transactions such as money laundering. Although the lack of information sharing can be justified by the confidentiality provisions in banking laws as well as in instances wherein there is no double-taxation agreement that is put in place to ensure that individuals and companies do not evade tax authorities;[32]

c) They comprise a lack of transparency in the operation of the legislative, legal or administrative provision. The Memorandum of Understanding ("MOU")[33] amplified what is meant by lack of transparency by referring to three (3) key concepts, namely: rules that depart from accepted laws and practice, secret rulings or provisions which makes it difficult to acquire knowledge of investments made in offshore haven jurisdiction and the ability to negotiate a rate of tax; and

d) These jurisdictions have no substantial activities within them. Their zero or minimal tax rates aim to attract investments and are purely tax driven in nature. This characteristic is influenced by the idea that such jurisdictions normally cannot provide a legal or commercial environment and cannot offer

[32] Antoine RMB (2014) 20 states as follows: "if confidentiality laws are allowed to obstruct law enforcement investigations, they could lead to an erosion of the public's confidence in criminal justice systems worldwide, as many criminal activities, such as money laundering, which may thrive on secrecy, including offshore secrecy, are international in scope."
[33] OECD "Directorate for financial and enterprise affairs competition committee" (2016) http://bit.ly/2elbGJO (accessed 29 October 2016) 6. See also OECD "Competition co-operation and enforcement inventory of co-operation agreements" (2016) Report available at http://bit.ly/2eShgXG (accessed 29 October 2016) 1. See also Samuels LB (2001) 234 "The MOU sets out the standard for reform measures for tax havens that wish to avoid inclusion on the list of uncooperative Tax havens".

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any economic advantages to individuals or companies except to minimise their tax in order to attract new investors.

In addition to the abovementioned factors, harmful preferential tax regimes are distinguished by factors such as jurisdiction which are able to hold passive investments and act as a conduit for routing capital flow across the board through money laundering, financing of terrorism, trafficking and other types of transnational crime. [34]

2.6. Factors to identify a tax haven as a harmful preferential tax regime

2.6.1. They have no tax or low effective tax rate on relevant income. Although this is a starting point to determine a harmful preferential regime, it is however not the only factor to take into consideration when determining whether a specific tax regime is preferential. At least one of the factors set out below needs to be present.[35]

2.6.2. They consist of ring fencing provisions that explicitly or implicitly exclude residents from taking advantage of its benefits and enterprises as benefits from the regime are explicitly or implicitly prohibited from operating in the domestic market. Countries with the ring fenced provisions protect themselves from harmful effect of its own regime. However, this has an adverse impact on other foreign countries in that the international communities essentially bear the tax loss from the income and capital flows routed to countries with such provisions for example if more people evade tax by making investments in jurisdictions that levy zero to minimal tax, this will create a shortfall in revenue collection within a country which effectively means government will not be able to deliver services to the people as there will be no money. Therefore, these regimes benefit from the geographically

[34] OECD 1998 Report available at available at http://bit.ly/1pErl4a (accessed 15 May 2016) 25-29. See also Samuels LB (2001) 237-238.
[35] Samuels LB (2001) 237 see also OECD 1998 Report available at available at http://bit.ly/1pErl4a (accessed 15 May 2016) 26.

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mobile services it attracts without incurring any tax disadvantages in respect to resident taxpayers.[36]

2.6.3. The jurisdictions are not transparent which makes it hard for countries affected with these preferential regimes to curb them from creating harmful tax competition within their economy. The Global Forum is implementing standards of automatic exchange of information for tax purposes in order to minimise the harmful effects of these type of provisions.[37]

2.6.4. Lack of effective exchange of information amongst these jurisdictions and other jurisdictions is a clear indication of a harmful preferential regime in that the country to which that individual or corporation is a resident is unable to detect the activities of its residents in that jurisdiction.

Harmful tax competition has the effect of distorting trade and investments and eroding national tax bases by diverting investments from real productive onshore activities and directing it towards unproductive offshore financial instrument.[38] The OECD Report has brought forward the concept of global transparency in order to combat tax evasion.[39] The secrecy provisions in tax havens and OFC makes it attractive to multinational enterprise, wealthy individuals as well as transnational crimes, it also assists criminals by financing of terrorism.[40]

Individuals and companies may use tax haven jurisdictions to perform legal and illegal activities.[41] They are used to hide assets and income from onshore jurisdiction in order

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[36] Samuels LB (2001) at 237 see also OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 26-27.
[37]OECD Global Forum on Transparency and exchange of information for tax purposes: Exchange of information on request hand book for peer reviews 2016-2020 (2016) available at http://bit.ly/2clTDmZ (date accessed 8 September 2016) 10. See also Samuels LB (2001) 237. See also OECD 1998 Report available at http://bit.ly/2dHKO7V (accessed 15 May 2016) 10.
[38] Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.
[39] Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.
[40] Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.
[41] Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 37.

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to minimise or evade their tax liability in totality.[42] Another reason for the use of tax havens by financial institutions is to circumvent domestic regulations that prevent them from undertaking illegal activities such as money laundering. State owned development finance institutions, on the other hand, use tax havens as locations for intermediate holding funds and to participate in other fund located in those locations.[43]

The OECD stated in its 1998 report that the practices of tax havens could be extremely harmful. They can erode national tax bases of other countries and may alter the structure of taxation by shifting part of the tax burden from mobile to relatively immobile economic sectors and from income to consumption. The aforementioned has the effect that it can discourage compliance by taxpayers. Recent media has exposed some companies that have been evading taxes through various methods.[44] When looking at the method of tax used in Panama, it is apparent why an individual or corporation may be attracted to invest in jurisdictions such as these. Panama is well-known across the globe as an International Financial Centre.[45] It provides a territorial system which only taxes income generated within the Republic of Panama. The system used in Pananma is applicable to both residents[46] and non-residents, individuals, legal entities as well as

[42]Schneider J (1996) 60. See also Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 38.

[43]Murphy R Investment for development: Derailed to Tax Havens (2010) available at http://bit.ly/2co12Sg (accessed 23 July 2016) at 12. See also Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 8.

[44] Visser A (2016) 5. See also Wal-mart Stores was exposed in Fin24 is this the best source? to be owning more than $76 bn of assets through a web of units in offshore tax havens around the world. Fin24 also published an article wherein the Panama papers linked a South African Law firm Phatshoane Henney Attorneys to more than 400 entities in the Panama papers. The EU has threatened to sanction tax havens such as Panama if they continue to refuse to corporate fully to fight money laundering and tax evasion. See Campion-Smith B "High-risk" taxpayers, offshore tax havens part of Ottawa crackdownThe Star Newspaper Article available at http://on.thes tar.com/2cp8hMP (accessed 11 October 2016) Panamanian law firm Mossack Fonseca comprise the largest journalistic leak in history, which has been analyzed and corroborated by journalists at over 100 news organizations around the world, including the Star. The ensuing reports have implicated a dozen world leaders in offshore dealings, including Iceland's Prime Minister Sigmundur Gunnlaugsson, who resigned last week, and the U.K.'s David Cameron, who admitted to profiting from offshore investments.

[45] Grundy M *Grundy's tax havens: A world survey* (1987) at 77-78. See also Starchild A (1994) 45-47.

[46]A South African resident is defined in Section 1 of the Income Tax Act 58 of 1962. See also Terry-Lloyd JJ A critical commentary and analysis of South African Tax Legislation affecting the different offshore investment structures that are available to residents (2002) 15. See also Starchild A (1994) 46.

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trusts. Panama has become popular as a place for the organisation of holding companies of international groups.[47] It has also become a place for organisation of the personal holdings of their main shareholders and investors, as well as a location for estate planning through the use of private interest foundation.[48] Jurisdictions such as Panama require a company to decide upon incorporation whether it wants to do local business or only foreign business, which essentially means that it cannot be taxed on its world-wide profits.[49] This chapter dealt with factors that make a tax haven a harmful preferential regime and the Panama has recently committed itself to the Automatic Exchange of information for tax purposes.

2.7. Conclusion

In order to run a country's economy effectively, government needs to collect income tax and corporate tax from individuals and companies respectively. Jurisdictions which provide harmful preferential regimes make it hard to collect such in that they create an attractive investment opportunity in tax havens which encourages tax evasion. The nature of tax haven jurisdictions as well as OFC is such that it creates a harmful preferential regime towards government, small businesses, as well as individuals. Tax havens favour the rich and big companies, in that in the event there is a shortfall in the revenue collection within a country, this will be paid by the middle class individuals and small businesses. In other words, the shortfall in revenue collection causes government to increase the tax rate in order to collect additional income to run a country. The effect of preferential regimes is that government is under-funded due to these preferential regimes. This has a detrimental effect in that public investments are a necessity towards promoting the development and rapid growth within a country. Tax haven jurisdictions are those jurisdictions that levy minimal tax or zero taxes with the purpose of attracting investors. As a result of the global need for transparency, the OECD initiative of automatic exchange of information could expose criminal activities, and other tax evaders from continuing to conduct activities that affect the economic

[47] Grundy M and Aparna N *Offshore business centres: A world survey* (2008) 81-183
[48] Grundy M and Aparna N (2008) 181-183.
[49] Hadnum L *The world's best tax havens* (2009) 3-4. See also Rosenzweig AH "Why are there tax havens?" (2010) 968.

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growth globally. More papers such as the Panama papers need to be used on a regular basis to expose more illicit flows of money into tax haven jurisdictions. Individuals are attracted by the low tax rates developed tax policies aimed at concealing finance and other mobile capital from countries with high tax rates. The conduct of tax haven jurisdictions prejudices the onshore countries in that the capital inflow is reduced by offshore investments which are not taxed.

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CHAPTER 3

3. ADVANTAGES AND DISADVANTAGES OF INVESTMENTS MADE IN A TAX HAVENS

3.1. Introduction

To a large extent, tax havens are regarded to have a detrimental effect on the general economy globally in that they contribute towards tax evasion, crimes, money laundering and other crimes which affect the economic growth in both developed and developing countries.[1] This chapter deals with the advantages and disadvantages of tax havens as well as the effects that tax haven jurisdictions have in total revenue collection internationally. Tax haven jurisdictions are not necessarily always appealing to both individuals and companies. Tax haven jurisdictions that do not have corporate tax are appealing to companies whereas jurisdictions that do not levy tax on income would be more appealing to an individual than a corporation.[2] This chapter will deal with the advantages and disadvantages of investments made in a tax haven jurisdiction or a harmful preferential regime which is appealing to both individuals and corporations.

3.2. Advantages of investments made in tax haven jurisdictions

One of the most obvious benefits of tax haven jurisdictions is that individuals or companies are not taxed or the rate at which they are taxed is minimal. The advantages of tax haven jurisdictions are that individuals and companies that invest in these jurisdictions are able to reduce their domestic tax liabilities through transfer pricing.[3] They are also able to enjoy the benefits within their country of resident without having to contribute towards tax.[4] One of the essential benefits of tax haven

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[1] Murphy R (2010) available at http://bit.ly/2c7sZ1r (accessed 23 July 2016) 13.
[2] Crawley T (1978) 16.
[3] Jones JFA *Tax havens and measures against tax evasion and avoidance in the EEC* (1974) 3. Transfer pricing provides multinational corporations an opportunity to set-up offshore companies through which most transactions occur without having to pay as much taxation.
[4] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 14.

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jurisdictions is the secrecy provision and lack of information sharing with tax authorities. The aforementioned benefits makes these jurisdictions appealing to tax evaders and illegal activities such as illicit flow of money. Tax havens offer confidentiality or banking secrecy[5] as well as the lack of exchange of information with other jurisdictions and tax authorities which enable tax evasion and avoidance practices. It enables taxpayers to remain anonymous from tax authorities thereby making them appealing to investors who intend to evade tax.[6] Due to the fact that tax haven jurisdictions often attract businesses, mobile finance and investment capital, the jurisdiction benefits from an increase in revenue collection from offshore investments.[7]

3.3. How individuals and companies benefit from tax haven jurisdictions

Tax evasion occurs when a taxpayer fails to declare all or part of his or her income or makes a claim to offset an expense against his or her taxable income that he or she did not incur and was not allowed to claim for tax purposes. Due to the technological advancement and growth in the use of internet, individuals can now obtain foreign investments directly through the internet, such as stocks and bonds or put money in their foreign bank account located in tax haven jurisdictions and simply not declare the income. Individuals may also use structures such as trusts or shell companies to evade tax on their investments.[8] The secrecy provisions make tax haven jurisdictions appealing to individual resident in jurisdictions with very high tax rates that effectively creates unfair competition in that it forces countries with high tax rates to reduce their rates in order to reduce tax evasion

[5] The concept of confidential and banking secrecy is dealt with in chapter 2. Bank secrecy is a concept used for non-disclosure of transactions. The non-disclosure is usually is based on the legal protection of information held by financial institutions in tax haven states which may be largely based on statutes, common law precedent or administrative practices.
[6] Petr Janský (2013) available at http://bit.ly/2clXpgd (date accessed 12 September 2016) 5.
[7] Phumaphi S (2014) 18.
[8] Gravelle GJ (2015) available at http://bit.ly/1fIblAV (accessed 22 May 2016) 24. See also Palan R *et al* (2010) 68. See also Schneider J (1996) 63-65. Individuals or corporations may buy and sell through shell companies without reporting the international transactions which means thereby avoiding any taxes on the profits. Shell trust on the other hand may be used by paying monies into the trust as a donation. This donation is subsequently paid to members in the form of cheap loans that are never paid back. The loans are subsequently written off.

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and avoidance. This form of competition encourages individuals and companies to move their monies and businesses to their shell companies which are located in tax havens in order to pay minimum tax onshore or to evade South African income tax or corporate tax completely.

Some institutions, such as the International Business Corporation ("IBC"), are incorporated due to their multipurpose component. These companies are often set up in tax haven jurisdictions either as subsidiaries, of onshore companies or as independent companies.[9] The main purpose of these companies is to shift the profitable portion of a business to a tax haven jurisdiction.[10] The IBC raise capital by issuing shares, bonds and other instruments. They may also be used for the possession of intellectual property rights[11], organisation of trading on financial markets, managing investments funds and as part of a complex financial structure. An offshore IBC's characteristics attracts criminal activities in that there are low costs of incorporation and they are governed by characteristics such as secrecy of ownership which may be done by using a nominee name in order to hide the true identity of the owners of the said company.[12] There is no requirement to file accounts on public records and such companies are protected from creditors and are not liable for any debts of the company once they have paid for their shares.[13] It is hard to conduct investigations on these companies due to the fact that tax evaders constantly change the *domicilium*[14] of the company. This ultimately means that authorities will have difficulties in tracing a company's place of residence in

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[9] Palan R *et al* (2010) 69.
[10]Porter N (2014) 89-90 see also, Palan R *et al* (2010) 69.
[11] It refers to creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce.
[12] Palan R *et al* (2010) 68-69.
[13] Palan R *et al* (2010)68-69.
[14] Jones JFA (1974) 13. The term *domiciluim* is a Latin term for domicile. This term is defined in sections 1, 2 and 3 of the Domicile Act 3 of 1992. The Act makes distinguishes between Three different types of domicile. Namely: Domicile of choice; Domicile of person who cannot acquire domicile of choice; and Succession of domicile. The important definition to take note of is of a domicile of choice. A domicile of choice shall be acquired by a person when he is lawfully present at a particular place and has the intention to settle there for an indefinite period.

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order to make an inquiry[15] This consequently hampers any chance of securing an effective exchange of information between countries.[16]

3.4. Disadvantages of investments made in tax haven jurisdictions:

Tax haven jurisdictions contribute towards the loss of tax revenues internationally by encouraging and attracting investors to invest money in those jurisdictions. Due to the fact that income is outsourced to offshore centres, it contributes towards maintenance of tax haven jurisdictions in that it provides these jurisdictions with enough capital to enable growth which adversely affects other jurisdictions which do not have preferential tax regimes.[17] The secrecy provision in tax haven jurisdictions makes it easy for criminals to perform acts of money laundering and tax evasion as it is difficult for the onshore country to investigate the financial affairs of these companies and individuals on an international level.[18] It contributes towards misallocation of investment funds due to the lack of transparency in itself which causes an increase on costs of public services due to the diversion of funds into offshore tax haven jurisdictions.[19] Tax haven jurisdictions also contribute to the risk that investments fail to meet governance criteria in that there may be no limited ability to ensure that investments in these jurisdictions meet proper environment, social and governance standards.[20] The Development Finance Institutions ("DFI") is aimed at servicing the investment shortfalls of

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[15] Palan R *et al* (2010) 68-69.

[16] Palan R *et al* (2010) 69. Companies such as Limited Liability Partnership ("LLP") protects tax haven registered companies from claims. Protected Cell Companies ("PCC"), on the other hand, operate as if they are a group of separate companies despite the fact that are all part of the same legal entity. Due to the lack of transparency, it is often difficult to tell that a company is a protected cell of another company or whether there is a relationship between different companies, which bear different names. Due to the lack of transparency, in the event that one of the cells becomes insolvent, creditors only have a recourse against that particular cell and not to any other company in this group.

[17] Eriksson F "Tax havens and Development report by the independent Norwegian Commission on capital flight from developing countries" available at http://bit.ly/2e2LwL1 (accessed 22 May 2016) 65.

[18] Eriksson F available at http://bit.ly/2e2LwL1 (accessed 22 May 2016) 67.

[19] Murphy R (2010) available at http://bit.ly/2c7sZ1r (accessed 23 July 2016) 12.

[20] Murphy R (2010) available at http://bit.ly/2c7sZ1r (accessed 23 July 2016) 13.

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underdeveloped and developing countries by bridging the gap between commercial investment and state development.[21]

The problems with tax haven jurisdictions or OFCs are that they encourage industrialised countries to reduce their tax rates in order to avoid capital leakage of funds due to unlawful investments within their countries.[22] Large companies together with the richest people in society take advantage of these jurisdictions to avoid paying tax rates, thus transferring the burden of taxation to the rest of the society.[23] The fact that these jurisdictions are governed by secrecy provisions and minimal regulations to facilitate tax evasion and transactional crimes, create a substantial problem in ensuring that the minimal tax rates do not amount to harmful tax competition.[24] These jurisdictions enable the holding of funds in secret offshore financial centres which enable individuals and companies to hide vital information from the government as well as the public.[25]

Tax haven jurisdictions and OFC enable transfer pricing[26] by multinational enterprises that reduce their tax liabilities in high tax jurisdiction by transferring profits to a lower tax rate- or zero tax rate jurisdictions. These harmful tax regimes are damaging towards the revenue collection within a country.[27] The detrimental effects of investments made in tax haven jurisdictions are that they divert

[21] Dickinson T Development Finance Institutions: Profitability Promoting Development available at http://bit.ly/2cdzOhS (accessed 3 September 2016) 3. DFI's provide a broad range of financial services in developing countries, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds and financing for public infrastructure projects. Also see Murphy R (2010) available at http://bit.ly/2c7sZ1r (accessed 23 July 2016) 13. Tax havens have a detrimental effect on the economy and individuals in that there is minimal growth in a countries economy and it affects non-tax evaders in that the tax rates increase in order to lose the gap between the different classes of society.
[22] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed19 July 2016) at 9.
[23] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) at 26.
[24] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) at 26.
[25] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.
[26] SARS practice note 7 available at http://bit.ly/2bPN9we (date accessed 22 August 2016) 3 describes transfer pricing as the process by which entities set the price at which they transfer goods or services to connected persons. In other words, this is a form of tax avoidance that result from related entities setting prices at which they transfer goods and services between each other in order to reduce or increase profits artificially. Legwaila T "Tax impediments to holding company structure in Belgium, Ireland and the United Kingdom: Caution for South Africa" (2010) 541.
[27] White D (2009)11. See also Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.

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investments from onshore productive activities and projects to offshore unproductive financial instruments.[28]

The competition raised by these jurisdictions together with the OFC causes onshore jurisdiction to decrease tax rates in order to compete with offshore jurisdictions to prohibit the amount of cash outflow within a country.[29] The secrecy of tax havens and their lack of corporation with other countries make it easy to be misused for criminal activities, money laundering, financing of terrorism, trafficking and other types of transnational crimes.[30] There is a need for countries such as South Africa to have a financial supervisory system which would create transnational or global regulatory institutions that will promote sharing of information and piecing the veil of secrecy in order to avoid tax evasion.[31]

3.5. Conclusion

Tax haven are indeed beneficial to the 3 (three) main role players, namely the individuals, companies as well as the tax haven jurisdictions equally benefit from offshore investments. This comes at a cost toward the economic growth of countries that do not have preferential regimes that enable individuals and companies to evade tax. The problem in curbing harmful tax practices is the lack of information sharing, secrecy provisions and complex organisational structures which makes it difficult to identify the beneficial owners of offshore accounts or companies. Tax haven jurisdictions exist world-wide, and curbing them from creating harmful tax competition can only be done through international agreements. There is a need to have multilateral agreements to enable countries to exchange information. This may possibly reduce the impact they have in the global economic growth and revenue collection. I opine that the harmful tax competition created by these tax havens or secrecy jurisdictions can be successfully curbed by the recommendations set out by the OECD. If jurisdictions

[28] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) at 34.
[29] Blomeyer (2013) available at http://bit.ly/2bEHxsE (accessed 19 July 2016) at 26.
[30] Blomeyer http://bit.ly/2bEHxsE (accessed 19 July 2016) at 39.
[31] Gravelle GJ (2015) available at http://bit.ly/1QsutB5 (accessed 22 May 2016).

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sign multinational agreements to exchange information for tax purposes, this will enable an onshore country to be able to trace income of its taxpayers world-wide.

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CHAPTER 4

4. THE EXTENT OF SOUTH AFRICA'S COMPLIANCE WITH THE OECD's RECOMMENDATIONS CONTAINED IN THE 1998 REPORT ON HARMFUL TAX COMPETITION

4.1. Introduction

The OECD provides a forum which enables governments to work together in finding solutions, solving common problems and sharing experiences. The OECD currently has 35 member countries.[1] South Africa is one of many non-members of the OECD but it has a working relationship with the OECD. In 1996, Ministers of the member countries called upon the OECD to develop measures to counter harmful tax competitions on investments.[2] As a result, the OECD began a project on harmful tax competition. The OECD council at ministerial level adopted a resolution in May 2007 to strengthen the co-operation with South Africa and other countries[3] through a programme of enhanced engagement.[4] Since then, South Africa is one of the countries considered to be a key partner with the OECD in that it actively participates in the OECD's initiatives and adheres to the OECD's projects although it is not a member. South Africa has associated itself with about 7 bodies and projects of the OECD and it is a participant in 13 projects of the OECD.[5] South Africa has also adhered to 11 OECD instruments over the years including the

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[1]OECD "Members and partners" http://bit.ly/1fxLB6q (accessed 27 October 2016). The OECD has about 35 member countries namely: Australia; Austria; Belgium; Canada; Chile; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hungary; Iceland; Ireland; Israël; Italy; Japan; Korea; Latvia; Luxembourg; Mexico; Netherlands; New Zealand; Norway; Poland; Portugal; Slovak Republic; Slovenia; Spain; Sweden; Switzerland; Turkey; United Kingdom; and the United States

[2] OECD http://bit.ly/1fxLB6q (accessed 27 October 2016). Also see the OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 3.

[3] The OECD 2007 resolution also included a co-operation with Brazil, China, India and Indonesia. South Africa together with 4 Countries are considered as key partners to the OECD in that they contribute to the OECD's work in a comprehensive and actively participate in the work of the Organisation.

[4]OECD "South Africa and the OECD" available at http://bit.ly/1CnfcYf (accessed 26 October 2016)

[5] OECD "South Africa's participation in the OECD activities" available at http://bit.ly/1CnfcYf (accessed 26 October 2016)

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automatic exchange of information for tax purposes. In 1998 the OECD published a report on harmful tax competition which addressed the impacts of tax havens and the harmful preferential regimes on both OECD member countries and non-member countries.[6] The aforementioned report is the subject of this chapter. The 1998 OECD report consisted of 19 recommendations which were divided into 3 groups.

This chapter will firstly, give a brief outline of the 3 groups of recommendations and guidelines which are set out in the OECD's 1998 report on harmful tax competition, namely: Recommendations dealing with domestic legislation; Recommendations dealing with tax treaties; and Recommendations to intensifying international co-operation; Secondly, it deals with the extent to which South Africa is applying and implementing those recommendations to curb harmful preferential tax regimes; Thirdly, it analyses the guidelines on how countries can implement these recommendations in order to conform with international standards to curb harmful tax practices; and Lastly, it deals with the global standards which encourage transparency and sharing of information for tax purposes including the declaration on automatic exchange of information in tax matters that South Africa has recently adhered to in line with the OECD recommendations.

4.2. A brief summary of the OECD's 3 groups of recommendations and the extent to which South Africa has aligned itself to those recommendations

The three groups of recommendations to curb harmful tax regimes are summarised and set out herein below:

4.2.1. Group 1: Recommendations concerning domestic legislation;[7]

The recommendations under this group provide guidelines on how countries may use their domestic laws to increase their effectiveness in order to curb

[6] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 3.
[7] This group of recommendations include 7 recommendations by the OECD dealing with CFC; Foreign Investments; restriction on exemptions; foreign information reporting; ruling regarding taxpayers positions; Transfer pricing; and access to banking information.

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harmful tax practices. The OECD recommends that countries should enforce laws that enable tax to be paid on the hands of a resident taxpayer.[8] This will limit the deferral of taxable income through foreign subsidiaries.[9] In circumstances that the CFC is not sufficient to curb harmful tax practices, the OECD recommends its member countries to also develop foreign investment rules or similar rules in order to cater for the loopholes that may be created. When dealing with transfer pricing between related companies, the OECD recommends that the 1995 guidelines by the OECD on transfer pricing should be used.[10] It is also recommended that banking information should be accessible to authorities in order to effectively manage and counteract harmful preferential regimes. Foreign income derived from harmful tax competition should not qualify for application of exemption method.[11] These exceptions may exclude certain income based on its origin,[12] type or the rate of tax to which that income has been subjected to.[13] The Purpose of the OECD is for countries to co-operate and share experiences and ideas. In order to effectively manage resident taxpayer's cash flow transactions and offshore accounts. Countries are encouraged to develop a standard of transparency and automatic sharing of information in order to identify beneficial owners. The OECD has indicated that failure to adhere to these international transfer pricing principles will be a contributing factor towards the spread of harmful tax regimes.[14] The OECD has also identified offshore trusts as a vehicle used by taxpayers in an attempt to evade tax by hiding the identities of the beneficial owners of the offshore

[8] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 40-41
[9] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 41.
[10] Eriksson F available at http://bit.ly/2e2LwL1 (accessed 22 May 2016) 68-69. See also OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 45.
[11] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 43.
[12] Terry-Lloyd JJ (2002) 40.
[13] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 43.
[14] White D (2009) 10. See also OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 45.

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assets.[15] In this regard, it has recommended that countries exchange information about taxpayers' beneficial ownership in offshore trusts.[16]

(a) South Africa's position

Before January 2001, South African tax was based on the source-based taxation system which meant that tax was based on the source from which it was derived from.[17] The residence-based system of taxation was phased in by the introduction of Section 9D to Income Tax Act,[18] in respect of investment income accruing to South African residents. Under the residence based (world-wide tax base) system of taxation, South African residents[19] are subject to tax on their income earned domestically and abroad.[20] There have been some concerns about South Africa's headquarter Section 9I of the Income Tax Act which makes provision for headquarter companies[21] regime

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[15] The beneficial owner are the people that derive a benefit from companies, trusts or accounts.
[16] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 46. See also Oguttu AW (2010) 190-195. A beneficial owner in this context refers to a person who derives a benefit or an advantage from investments made in tax havens.
[17] Grundy M *Grundy's tax havens offshore business centres: A world survey* (1993) at 117. See also SARS Legal policy: Taxation in South Africa 2015/2016 available at http://bit.ly/1PRHHGN (accessed 28 October 2016) 9-10. See also Engel K "National treasury's detailed explanation to section 9d of the Income Tax Act" (2002) available at http://bit.ly/2doyWHT (date accessed 3rd October 2016) 5. See also Stander R *The tax base of South African individuals: An international comparison* (2013) 9.
[18] CFC is defined in section 9D (1) of the Income Tax Act to mean any foreign company where more than 50% of the total participation right in that foreign company are directly or indirectly held, or more than 50% of the voting rights in the foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies.
[18] Section 9D of the Income Tax Act. There are certain exceptions to this rule as set out in section 9D(9)(b) of the Income Tax Act.
[19] In terms of Section 1 of the Income Tax Act 58 of 1962 a person is regarded as a resident when "…any natural person is ordinarily resident in a Republic or not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment…"
[20] Act 58 of 1962. See also Starchild A (1979) 5.
[21] Act 58 of 1962. See also OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 13 Oguttu AW "Developing South Africa as a gateway for foreign investment in Africa: a critique of South Africa's head quarter company regime" (2011) 66. Oguttu defines a

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and whether it constitutes a harmful tax practice. In this regard, the OECD held in its 2000 Report that holding company regimes and similar preferential tax regimes do not constitute harmful tax practices although they may constitute a harmful tax competition.[22] The OECD has not found South Africa's headquarter regime as a harmful preferential regime.

The following domestic legislations were enacted in compliance with the above-mentioned recommendations:

(1) The Income Tax Act:

a) Section 9D: the effect of this section is that companies that are resident in South Africa are taxable on their world-wide income. In the event that a South African company sets up a subsidiary within a different jurisdiction, South Africa will not be able to directly tax the subsidiary company. However, upon distribution of dividends to a South African Shareholder, South Africa will be entitled to tax the shareholders on the dividends received from a foreign company.

   Section 9D is designed to prevent deferral through South African owned foreign entities.[23] The section enables SARS to tax the South African shareholders on their foreign income. [24] In other words, the introduction of the residence basis of taxation makes it possible for South Africa to tax on the world-wide income of a South African

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headquarter companies as a type of intermediary holding company with special management functions that are not necessarily carried out by intermediary holding companies. The headquarter regime is actually a holding company regime which enables MNE's to use South Africa as a conduit for passive income flow.

[22] OECD "Towards global tax co-operation report to the 2000 ministerial council meeting and recommendations by the committee on fiscal affairs" (2000) Report available at http://bit.ly/2eK5sU6 (accessed 27 October 2016) 15.

[23] Section 1 of the Income Tax Act defines a Foreign Company to include any company, including a close corporation, an association, scheme or a co-operative that is not resident in South Africa. This definition also refers to protected cell companies. Stiglingh M *et al Silke: South African Income Tax Law 2012* (2011) 595.

[24] Act 58 of 1962. See also Oguttu AW "Resolving the conflict between "Control Foreign Company" legislation and tax treaties: A South African perspective" (2009) 101-102.

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resident company. The purpose of Section 9D is to apportion investment income accruing to a "controlled foreign entity", from any source outside South Africa, to South African residents, and to include these apportioned amounts as part of the South African resident shareholder's income.[25] For example, if a South African resident owns fixed property in a foreign country that generates rental income, that resident will be subject to tax on this rental income in South Africa which is subject to Double Tax Agreements ("DTA") if South Africa and the foreign country have concluded one. This form of taxation could easily be avoided by simply creating a CFC and placing the property and income into that company. To prevent the aforementioned deferral of income in an attempt to avoid tax, section 9D was created to cast a wide net to prevent the avoidance of taxation by South African residents using foreign companies and intermediaries.[26] This is done by interposing a headquarter company in a jurisdiction with CFC legislation, provided that the intermediary jurisdiction's CFC legislation is applicable to the intermediary foreign headquarter company.[27] South Africa applies its CFC regulations to all CFCs wherever there are South African residents and irrespective of the foreign tax rates applicable. There are however exceptions to this rule for companies where the bulk of the income is from active business, notwithstanding the fact that the company is resident in a low-tax jurisdiction.[28] A CFC resident in a tax haven may thus be wholly exempt from this legislation if, for instance, all its income qualifies for exemption under the criteria set out by the foreign business establishment exemption.[29]

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[25] Singh KP *An international comparative study of South African controlled foreign company legislation* (2014) 2.
[26] Stiglingh M *et al* (2011) 595.
[27] Legwaila T "Tax reasons for establishing a headquarter company" (2011)129.
[28] Singh KP (2014) 252.
[29] Stonier LA *Taxation implications arising from South African residents investing abroad* (2009) 97.

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b) Section 72A (1): this section reassures the reporting of transactions as provided for in the OECD report by submitting an income tax return as contemplated in section 66 of the Income Tax Act.[30] This requirement essentially revolves around ensuring that information is accessible at all times and that countries should have rules which motivate reporting of international transactions and foreign operations of their resident taxpayers.

(2) Promotion and Protection of Investment bill 2015

The purpose of the Bill is to provide for the legislative protection of investors and the protection and promotion of investment; to achieve a balance of rights and obligations that apply to all investors; and to provide for matters connected therewith. This Bill was drafted in compliance with the OECD recommendations however, it has not been assented to by the President.[31]

(3) The Exchange Control Amnesty and Amendment Act.[32]

This Act encourages the disclosure of foreign assets and investments which is also in compliance with the recommendations by the OECD which requires countries to intensify their reporting standards by reporting international transactions.

[30] Section 72A (1) of the Income Tax Act provides that "every resident who on the last day of the foreign tax year of a CFC or immediately before a foreign company ceases to be a CFC directly or indirectly, together with any connected person in relation to that resident, holds at least 10% of the participating right in any CFC (otherwise than directly through a company which is a resident), must submit to the commissioner a return" as contemplated in section 66 of the Income Tax Act. Section 72A (3) of the Income Tax Act provides the sanction for non-compliance with section 72(A)(1) of the Income Tax Act which is that if such person has no reasonable ground for failure to comply with the aforementioned section or for that person to believe that he or she was not subject to the that requirement, the proportional amount that will be included in the income of that person for that year of assessment will be determined with reference only to the receipts and accruals of the CFC and the provisions of section 6quat will not be applicable to the government of any other country with respect to proportional amount of the net income of the CFC which is included in the income of that person in terms of section 9D.

[31] Promotion and Protection of Investment Bill 2015. See also Singh KP (2014) 135.

[32] Act 12 of 2003

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(4) Financial Intelligence Centre Act [33]

The FICA Act was created amongst other things, to counter money laundering activities and to impose duties on accountable institutions such as banks; attorneys; and financial instrument trader to clarify the application of the Act with regards to laws relating to sharing of information by the Financial Intelligence Centre and supervisory bodies.[34] Originally, section 78 of the Income Tax Administration Act provided that where the Commissioner had a reason to believe that a resident has not declared, or accounted for, any funds or assets owned outside the Republic, or where the income or capital gains from any funds or assets outside the Republic could be attributed to that resident in terms of any of the subsections of section 7, or Part X of the Eighth Schedule, the Commissioner had the powers to estimate the amount of foreign currency of such funds, or the market value of those assets, and include the estimated amount in the taxable income of that person. The above mentioned section has however been repealed by section 271 read with para. 64 of schedule 1 of the Act.[35]

The FICA Act was created to counter the growth of holding of undisclosed foreign asset into tax havens. Countries are also requested to follow principles set out in the OECD's 1995 guidelines on Transfer Pricing and avoid applying the Transfer Pricing rules in a way that will constitute a harmful tax practice. Transfer pricing relates to the prices of transferring goods between related companies. The OECD makes reference to the arm's length principle in order to curb transfer pricing.[36] Paragraph 1 of Article 9 of the OECD Model Tax Convention deals with the arm's length principle as follows:

[33] Act 38 of 2001
[34] Preamble of the Financial Intelligence Centre Act 38 of 2001.
[35] Act 28 of 2011
[36] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 31.

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> "[When] conditions are made or imposed between … two [associated] enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The standard transfer pricing methods recognised by the OECD Guidelines, are: the comparable uncontrolled price method (CUP method); the resale price method (RP method); the cost plus method (CP method); the transactional net margin method (TNMM); and the profit split method.[37] The aforementioned guidelines where based on the OECD's 1995 guidelines which has been revised in the Transfer pricing documentation 2015.[38] South Africa applies the arm's length principle to transactions. The burden of proof is on the taxpayer to illustrate that the operation was in compliance with the arm's length principle.[39] Section 31 of the Income Tax Act was introduced into the Act with effect from 19 July 1995 to counter transfer pricing practices which may have adverse tax implications for the South African fiscus. This section consists of a combination of transfer pricing and thin capitalisation provisions.

South Africa has put in place a transfer pricing legislation in terms of section 31(2) of the Income Tax Act[40] which provides as follows:

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[37] SARS practice note 7 available at http://bit.ly/2bPN9we (date accessed 22 August 2016) 13.
[38] OECD/G20 base erosion and profit shifting: Transfer pricing documentation and country-by country reporting (2015) Report available at http://bit.ly/1PRHHGN (accessed 28 October 2016) 14. The OECD now recommends for countries to adopt a standardised approach to transfer pricing documentation that follow the three-tiered structure consisting of a master file, a local file and a country by country reporting. This standardised approach still needs to be adopted by South Africa.
[39] SARS "Legal policy" available at http://bit.ly/1PRHHGN (accessed 28 October 2016) 53.
[40] See section 31(2) of the Income Tax Act. Transfer pricing is the price companies charge for inter-group, cross-border sales of goods and services. The techniques consist amongst others the following: under-invoicing, over-invoicing, misreporting the quality or grade of imported products, misreporting the quantity of products and creating fictitious transactions for which payment is made. See Palan R *et al* (2010)68-69.

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"(2) Where-

a) Any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and
b) any term or condition of that transaction, operation, scheme, agreement or understanding-

i. is a term or condition contemplated in paragraph (b) of the definition of "affected transaction"; and
ii. results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,

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

The effect of section 31 (2) is that it requires a taxpayer to itself make any transfer pricing adjustments. South Africa still needs to adopt the standardised approach as revised by the OECD. SARS still needs to also amend interpretation note 7 to align it with these new standardised approach. Therefore, the abovementioned section enables the Commissioner to adjust the consideration in respect of a supply or acquisition of goods or services in terms of international agreements between connected parties or that are not within arm's length.[41] Article 9 of the Model Tax Convention which stipulates the arm's

[41] SARS practice note 7 available at http://bit.ly/2bPN9we (date accessed 22 August 2016) 7-8. Apart from the specific anti-avoidance provision in the Income Tax Act. There are general

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length principle is embodied in all treaties entered into with South Africa. South Africa is accordingly complying with this recommendation by the OECD.

With regard to the OECD's recommendation for countries to review their laws, regulations and practices which govern access to banking information in order to remove the impediments to the access to information by tax authorities.[42] In the year 2001 in South Africa, the Promotion of Access to Information Act[43] came into effect. The aforementioned Act gave effect to Section 32(2) of the constitutional right to access information. The promotion to access to information however conflicts with the implied term of confidentiality between a bankers and customer.

In *FirstRand Bank Ltd v Chaucer Publications (Pty) Ltd*[44] the position regarding the banking secrecy in South Africa was analysed. DJP Traverso pointed out that a banker's contractual obligation to preserve the confidentiality of its client's banking affairs had long been recognised in English law in the T*ournier case* .[45] In the aforementioned case, it was decided that a right of a customer to keep his affairs confidential is a legal right.[46] However, this right is a qualified legal right arising *ex contractu*.[47] Locally, a banker's duty of confidentiality had been recognised as early as 1914 in *Abrahams v Burns* [48] case where J Traverso concluded as follows:

> "It seems to me that for considerations of public policy the relationship between a bank and its client must be of a confidential nature. Equally – for considerations of public policy – this duty is subject to being overridden by a greater public interest."

anti avoidance provisions which are set out in section 80A to 80L of the Income Tax Act. The definition of "connected person" is in section 1 of the Income Tax Act.

[42] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 45.

[43] Act 2 of 2000

[44] 2008(2) SA 592 (CC).

[45] 1924 (1) KB 1 461.

[46] The consequence is that before confidential information is disclosed, a person's legal right to confidentiality needs to be weight with the public policies.

[47] This term is applied to such things as arise from a contract.

[48] 1914 CPD 452.

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It was also noted that, although the duty not to disclose rests with the bank, the privilege not to have the details of the dealings with the bank disclosed belonged to the client. It was therefore the client alone who could invoke this privilege and insist on the bank keeping its client's information confidential.[49]

South Africa has a Financial Intelligence Centre which deals with the exchange of information with supervisory bodies. It investigates and issues reports regarding suspicious transactions.[50] This assists in identifying unlawful activities of combating of money laundering in that undisclosed income will be traced and taxed accordingly. As stated in the *Chaucer Publications case,* although banking secrecy is a fundamental provision in the bank and client relationship it can be limited by greater public policy. Therefore, there would be a need to weigh a customer's right to confidentiality and secrecy with the greater public policy and principles. I opine that the provisions which unduly restrict access to information by tax authorities is a serious impediment to the fair and effective implementation of tax rules which may result in distortion of financial flows within the economy.

4.2.2. Group 2: Recommendations concerning tax treaties;

The recommendations under this group encourage countries to ensure that treaties are used effectively to curb harmful tax practices and ensuring that the benefits of a tax convention do not unintentionally make policies constituting harmful tax competition more attractive. The OECD recommends that countries intensify exchange of information programs through Multinational Convention for Mutual Assistances in tax matters.[51] Treaty benefits should be restricted and countries which have tax treaties with tax havens should consider terminating

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[49] *Abrahams v Burns* 1914 CPD 452.
[50] Financial Intelligence Centre FAIS Workshop Presented by The Financial Intelligence Centre (2013) available at http://bit.ly/2dGQQav (accessed 6 October 2016) 3.
[51] OECD 1998 Report available at http://bit.ly/1pErl4a (accessed 15 May 2016) 46. See also Jones JFA (1974) chapter 6

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such treaties or renegotiate them in a manner that will prevent treaty shopping.[52] The OECD report recommended that countries include provisions in their tax conventions which restrict treaty benefits and countries are also requested to consider ways of modifying existing provisions of Tax Convention such that they include provisions or classifications as are needed in that respect.[53]

(b) South Africa's Position

Currently, South Africa applies GAAR[54] and the Substance over form doctrine[55] as anti-avoidance provision. It also applies specific treaty provisions such as beneficial ownership provision. In an attempt to intensify the exchange of information concerning transactions in tax havens and preferential tax regimes constituting harmful tax competition, South Africa and many other countries enter into Multinational Convention for Mutual Assistance in Tax Matters as well as other Agreements between signatory countries.[56] Article 26 of the Model Convention provides that competent authorities of the Contracting States need to exchange information which is relevant for carrying out the provisions of this Convention and concerning issues revolving around taxes in so far as reasonably possible and foreseeable. [57]

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[52] Oguttu AW "Curbing 'treaty shopping': the 'beneficial ownership' provision analysed from a South African perspective" (2007) 242. See also OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 49-52.
[53] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 47.
[54] South Africa also has general anti-avoidance legislation that is set out in sections 80A-80L of the Income Tax Act. These anti-tax avoidance provisions are used to prevent tax evasion and avoidance.
[55] In *South African revenue bank v NWK Ltd* 2011 (2) SA 69 SCA this case outlined a method to which courts could ascertain the true nature of the transactions that are under scrutiny. Substance is determined by looking into the actual transaction and analysing whether the transaction has the necessary substance that a similar transaction would have.
[56] Johns RA (1983) 42. See also OECD 1998 Report 46.
[57] Article 26 (2003) available at http://bit.ly/1QsutB5 (accessed 8 October 2016) 40. The exchange of information Conventions/ Agreements/ Standards can be divided into the following: USA FATCA Intergovernmental Agreement; Multilateral Mutual Administrative Assistance (MAA) Conventions or Agreements; Bilateral Tax Information Exchange Agreements (TIEAs); and Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS). SARS "Exchange of information convention or agreement" available http://bit.ly/2dx44o5 (accessed 5th October 2016). The USA FATCA Intergovernmental Agreement is an agreement between the governments (tax administrations) of the United States of America and the Republic of South Africa to

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South Africa is in the process of implementing an Automatic Exchange of Information ("AEOI") for tax purposes with the United States of America through an Inter-governmental agreement ("IGA") which was signed on 9 June 2014 in respect of USA's Foreign Account Compliance Act ("FATCA").[58] This agreement will work as follow: South Africa's financial institutions will collect and report on information required in terms of FATCA and the OECD common Reporting Standard on Financial accounts. The purpose of this is obtain financial account details from financial institutions and automatically exchange that information with other jurisdictions on an annual basis. This will be done under the legal framework which is provided for by the double tax agreement that exists between South Africa and the United States of America.[59] South Africa currently has a wide network of bilateral double taxation agreements in place which include provisions relating to the exchange of information for tax purposes. Certain of these agreements, such as those with the United Kingdom and Australia, also contain specific articles providing for mutual assistance in the collection of taxes.[60] It is hoped that entering into these agreements will help

exchange information automatically under the provisions of the double taxation agreement between these countries. The Standard for Automatic Exchange of Financial Account Information in Tax Matters (also referred to as the Common Reporting Standard or CRS) is the Global Model for automatic exchange of information under the Multilateral Competent Authority Convention to which South Africa is a signatory. The CRS is a standardised automatic exchange model, which builds on the FATCA IGA to maximise efficiency and minimise costs, except that the ambit is now extended to all foreign held accounts and not only those of US citizens. South Africa is also one of the early adopters of the CRS and is committed to commence exchange of information automatically on a wider front from 2017, together with over 96 other jurisdictions. Multilateral Mutual Administrative Assistance Conventions / Agreements are agreements between the governments (tax administrations) of two or more countries to enable them to exchange tax information on request, spontaneously or automatically, as well as to provide assistance in the collection of taxes. Bilateral TIEAs are agreements between the governments (tax administrations) of two countries to enable them to exchange tax information upon request.

[58] Strydom B "Mutual assistance and co-operation between the South African revenue service and foreign tax authorities" available at http://bit.ly/1oLKYXh (accessed 5 October 2016) 1. See also SARS "Automatic exchange of information (FATCA & CRS)" available at http://bit.ly/2dEieWx (accessed 4th October 2016).

[59] Article 23 of Government Gazette no. 18553 Government Notice no.1721 dates 15 December 1997. See SARS web page at http://bit.ly/2dEieWx (accessed 4th October 2016). See also Starchild A (1979) 9.

[60] Strydom B "Mutual assistance and co-operation between the South African revenue service and foreign tax authorities" available at http://bit.ly/1oLKYXh (accessed 5 October 2016) 1.

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South Africa obtain the necessary information to curb the harmful tax competition that is encouraged by tax havens and preferential tax regimes. Despite not being an OECD member country, most of South Africa's double tax treaties largely follow the OECD Model Tax Convention. South Africa has entered into Double Tax Agreements ("DTA") in terms of section 231 of the constitution of the Republic of South Africa[61] and section 108 (2) of the Income Tax Act[62] which provides for the prevention from double taxation. South Africa has also signed a few protocols to some old DTA to ensure transparency and effective exchange of information for tax purposes.[63]

I opine that the purpose of the OECD recommendations was to ensure that counties do not enter into treaties merely to derive benefits from it and to encourage countries to include in their treaties, provisions which govern the taxation of beneficial owners. Although the Income Tax Act does not provide a definition of a beneficial owner, the Draft Financial Intelligence Centre Amendment Bill, 2015 includes under Section 1 the definition of a beneficial owner. It defines a beneficial owner, in respect of a juristic person, to mean: "a natural person who independently or together with a connected person, directly or indirectly, including through bearer share holdings owns the juristic person; or exercises effective control of the juristic person." South Africa has started a process of renegotiating treaties in order to restrict treaty benefits. South Africa has renegotiated its treaty with Mauritius which provided that interest and royalties would be taxable only in the state where the owner resided in South Africa. Prior to renegotiating this treaty, South Africa could not impose tax on interest and royalties belonging to Mauritius resident companies or individuals. However, the new treaty allows South Africa to impose a 10 per cent tax rate on interest arising in South Africa to a resident of Mauritius and a 5 per cent tax rate on royalties.[64]

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[61] Act 108 of 1996
[62] Act 58 of 1962
[63] SARS "Rest of the world-double tax agreements and protocols" available at http://bit.ly/2eAfwl5 (accessed 27 October 2016) 1.
[64] Article 10 of the Government Gazette no.38862 Government Notice No. 471 dated 17 June 2015.

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The OECD requires that Commentary on the Model Tax Convention be clarified to remove any uncertainty or ambiguity regarding the compatibility of domestic anti-abuse measures with the Model Tax Convention.[65] This recommendation ensures that domestic anti-abuse rules and judicial doctrines are compatible with tax treaties.[66] Tax treaties require compatible domestic anti-avoidance rule (i.e. thin capitalisation, CFC rules and general anti-avoidance rules) to be incorporated into the treaties.[67] Thin Capitalisation is when a company is financed through a relatively high level of debt compared to equity.[68] Companies would use debts as a method to create a situation where interest payments would qualify for tax deductions in the high tax country and not be subject to tax in a tax haven jurisdiction. This position however changed upon the introduction of "thin capitalisation" rules.[69] The OECD recommends further that countries employ legislation to prevent the tax avoidance that results when a company is financed by the use of unusual proportions of loan to equity capital in order to gain tax advantages. The thin capitalisation rules limits the deductibility of interest payment in cases debts are being used in order to qualify for tax deductions.[70] South Africa's "thin capitalisation" provision is set out in section 31(3) of the Income Tax Act which provides as follows:

> "(3) To the extent that there is a difference between—
>
> > (a) any amount that is, after taking subsection (2) into account, applied in the calculation of the taxable income of any resident that is a party to an affected transaction; and

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[65] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 48.
[66] OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 48.
[67]Legwaila T (2010) 541.See also OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 48
[68] OECD Secretariat Thin capitalisation legislation: A background paper for country tax administrations August 2012 available at http://bit.ly/2cSKnVt (accessed 5th October 2016) 3.
[69] Bredenkamp M *An analysis of Section 23M in light of the OECD guidelines relating to thin Capitalisation* (2015) 8. See also OECD 1998 Report available at http://bit.ly/1pErI4a (accessed 15 May 2016) 62.
[70] Botha P (2010)) 26.

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(b) any amount that would, but for subsection (2), have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a),

the amount of that difference must, if that person is a resident and the other person to the affected transaction is a person as contemplated in paragraph (a)(i)(bb) or (a)(iii)(bb) of the definition of 'affected transaction'—

I. if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie declared and paid by that resident to that other person; or

II. if that resident is a person other than a company, be deemed, for purposes of Part V, to be a donation made by that resident to that other person,

on the last day of the period of six months following the end of the year of assessment in respect of which that adjustment is made: Provided that where the amount of that difference was prior to 1 January 2015 deemed to be a loan that constitutes an affected transaction, so much of that loan as has not been repaid before 1 January 2015 must—

(a) if that resident is a company, be deemed to be a dividend consisting of a distribution of an asset in specie that was declared and paid by that resident to that other person; or

(b) if that resident is a person other than a company, be deemed, for purposes of Part V, to be a donation made by that resident to that other person, on 1 January 2015."

With regard to the restriction on treaty benefits between the contracting states and to prevention of treaty shopping, South Africa applies the beneficial owner concepts in its treaties in order to assists and limit treaty benefits.[71] Article 1 of the OECD Model Tax Convention ("OECD MTC") suggests the following

[71] Oguttu AW (2007) 240.

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clauses that can be inserted in a tax treaty to curb the different cases of treaty shopping:[72]

1. The "look through" approach in which treaty benefits are disallowed for a company not owned, directly or indirectly, by residents of the State of which the company is a resident;
2. The subject-to-tax provision in terms of which a treaty benefits in the state of source can be granted only if the income in question is subject to tax in the state of residence;
3. Exclusion provisions which denies treaty benefits wherein specific types of companies enjoy tax privileges in their state of residence that facilitate conduit arrangements and harmful tax practices;
4. Provision that apply to subsequently enacted regimes which protects the signatory country against subsequent preferential regimes that could be adopted after the treaty is signed;
5. The "limitation of benefits" provision which aimed at preventing individuals who are not residents of the contracting states from accessing the benefits of a treaty through the use of an entity that would qualify as a resident of one of the States; and
6. The "beneficial ownership" clause which can be used to deal with source taxation of specific types of income.

South Africa is effectively implementing some clauses suggested in the OECD MTC. For example, South Africa and Kenya ratified a tax treaty entered into in 2010 and which is currently in force. In terms of Article 10.2 of the Tax treaty between South Africa and Kenya, it provides a clause for beneficial owner which deal with prevention of treaty shopping situations where income is paid to an intermediary resident of a treaty country who is not treated as the owner of that

[72] Adolfo J and Jiménez M "The 2003 revision of the OECD commentaries on the improper use of tax treaties: a case for the declining effect of the OECD commentaries?" (2004) International Bureau of Fiscal Documentation available at http://bit.ly/2dUihOs (accessed 7 October 2016) 21. See also Davis Tax Committee Interim report: Addressing base erosion and profit shifting in South Africa available at http://bit.ly/2dhBXdH (accessed 7 October 2016) 18.

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income for tax purposes (such as an agent or nominee).[73] There are other treaties that have been entered into in order to prevent harmful preferential tax benefits.

This provision has an effect of denying treaty benefits to a conduit company, unless the beneficial owner is a resident of one of the contracting states. South Africa had terminated Promotion and Protection of Investment treaty with Switzerland.[74] South Africa has also recently terminated its bilateral investment treaties ("BIT") with the Netherlands, Spain, Luxembourg and Belgium and Germany, and it appears that other cancellations are in the pipeline.[75] The termination was done in order to possibly re-negotiate and make new enactments on the promotion and protection of investments.[76] It is clear that South Africa is well on its way towards terminating and re-negotiating treaties with tax havens that create harmful preferential regimes.

South Africa's international relations focuses on both bilateral and multilateral agreements and through international organisations and the development of a regulatory framework such as forging strategic relationships bilaterally to enable joint audits, investigations and customs-to-customs partnerships.[77] It is however not clear whether South Africa has ever implemented these joint audits.

4.2.3. Group 3: Recommendations for intensification of international co-operation.

The recommendations under this group encourage countries to act collectively in curbing harmful tax practices. The OECD recommends that non-member countries engage in dialogue with member countries with the aim of promoting

[73] Government Gazette 39422 Government Notice No. 1158 dated 19 November 2015 at 20.
[74] Weidong Z "Creating a favourable legal environment for the sustainable development of China- Africa business relations" (2014) *Tydskrif vir die Suid-Afrikaanse Reg* 311.
[75] Weidong Z (2014) *Tydskrif vir die Suid-Afrikaanse Reg*311.
[76] Weidong Z (2014) *Tydskrif vir die Suid-Afrikaanse Reg* 311.
[77] SARS "International relation" available at http://bit.ly/2dhHXmZ (accessed 5th October 2016) 1.

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the recommendations. Countries that have any particular political, economic or other link with tax haven jurisdiction should ensure that such link or relationship does not contribute towards harmful tax competition. In an attempt to intensify international co-operation to prevent harmful tax practices, the Global Forum has initiated a project on transparency and exchange of information for tax purposes. The global forum on transparency and exchange of information for tax purposes is the multinational framework within which work relating to tax transparency and exchange of information are implemented. This is done though monitoring and peer review activities, technical assistance, peer learning and skills support.[78] This project enables international co-operation to automatically share tax information. The forum has been tasked with ensuring and monitoring compliance by various jurisdictions with regard to automatic information sharing.[79] It also analyses how the forum implements the task of ensuring that the OECD's recommendations are effectively implemented into our law.[80] It supports the implementation of international standards through an in-depth monitoring and peer reviews of implementation of the standards of transparency and exchange of information for tax purposes.[81] The peer review process involves a combination of formal recommendations in the peer review reports as well as informal dialogues by the peer jurisdictions in the peer jurisdictions, public scrutiny as well as the impact on all the domestic public opinion, national administration and policy makers.[82]

To ensure effective exchange of information, it is required that jurisdictions should ensure[83] that information is available to their competent authorities which identifies the owners of the companies as well as body corporates. In

[78] OECD (2014) available at http://bit.ly/1AvOS3v (accessed 30 July 2016) 16.
[79] Global Forum on Transparency and exchange of information for tax purposes: Exchange of information on request handbook for peer reviews 2016-2020 (2016) available at http://bit.ly/2clTDmZ (accessed 8 September 2016)15.
[80] OECD (2014) available at http://bit.ly/1AvOS3v (accessed 30 July 2016) 16.
[81]OECD Secretary-General report to G20 Finance Ministers 23 July 2016 available at http://bit.ly/2cH04BX (date accessed 8 September 2016) 11.
[82] Global Forum (2016) Report available at http://bit.ly/2clTDmZ (accessed 8 September 2016) 11.
[83] OECD (2016) available at http://bit.ly/2cH04BX (date accessed 8 September 2016) 16-20.

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circumstances where bearer shares[84] are issued, owners of such shares should be identifiable. When a partnership is formed within a jurisdiction, the identity of partners or beneficial owners in that partnership which has an income, deduction, or credit within that jurisdiction or carries business within that jurisdiction should be made available to competent authorities.

These jurisdictions should also ensure that information is made relating to the identity of founder members or beneficial owners is made available to competent authorities in circumstances whereby foundations are formed within that jurisdiction. It is also of paramount importance that reliable accounting records are kept for all relevant entities and arrangements which display and correctly explain all transactions. The accounting records should display the financial position of an entity and draw financial statements and that records such as contracts and invoices which reflects details of all sums of monies received and spent are kept. Banking institutions are also required to make available and accessible all information regarding all card holders of that bank.

The information requested should always be relevant and relate to all persons. A jurisdiction may not withhold information solely based on the fact that such information is either held by a financial institution, nominee or person acting as an agent or in a fiduciary capacity.[85] The purpose of the request for information is not material. The information may be requested for both civil and criminal tax matters, however, such access should be to the extent that the domestic laws of that specific jurisdiction allows.[86]

The Global Forum has become the world's leading multilateral body within which work relating to transparency and exchange of information is carried out.

[84] where the holder of the share in the corporation is unknown but can nevertheless enforce his rights as a shareholder see OECD "Global Forum on Tax Transparency: New reports review jurisdictions' information exchange" available at http://bit.ly/2eGHUCa (accessed 29 October 2016) 1.
[85] OECD Secretary-General 2016 Report available at http://bit.ly/2ctxZOL (date accessed 8 September 2016) 24.
[86] OECD (2016) Report available at http://bit.ly/2ctxZOL (date accessed 8 September 2016) 24.

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About 96 countries have shown commitment in implementation of transparency and exchange of information.[87] Amongst those countries is South Africa.[88]

(c) South Africa's position

South Africa's Department of International Relations and Co-operations ("DIRCO")[89] encourages a co-operation with African continents and emphasis on strengthening the South-South relations.[90] South Africa is one of the five key partners with the OECD which has a leading role.[91] In 2010, South Africa signed a Tax Information Exchange Agreement which is in line with the OECD standards which will enables SARS to access information relating to suspicious transactions of South African taxpayers that have invested in other jurisdictions in order to evade taxes.[92] This minimises the abuse of the confidentiality principle for criminal activities such as money laundering, insider trading and financing of terrorists' activities.[93] The effects of diverting income in foreign companies, trusts or other establishments based in tax haven jurisdictions has a serious impact on revenue collection within a country as well as the economic growth of the country. Although there are anti avoidance provisions in terms of the Income Tax Act, it still seems to be ineffective for as long as there is no global transparency between accountable institutions such as banks. Global transparency is the central point to ensure

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[87] OECD (2015) Report available http://bit.ly/2dGRQIK (accessed 4th October 2016) 13.
[88] South Africa which is the Chair of the Global Forum has indicated that it undertakes to automatically exchange information for tax purposes as from 2017.
[89] DIRCO is responsible for foreign policies, strategies and developing and implementing co-operation projects. See OECD "South Africa's Development Co-operation" available at http://bit.ly/2e01RQB (accessed 30 October 2016) 1. See also DIRCO "Strategic plan" (2010-2013) available at http://bit.ly/2fsK5KC (accessed 30 October 2016) 7. South Africa also engages with the North in other key global economic processes such as the Doha Development Round of the World Trade Organisation, the OECD, G8, World Intellectual Property Organisation and the World Customs Union ("WCU") in order to effectively promote the Africa agenda and to improve the interests of developing countries in general.
[90] See http://bit.ly/2e01RQB (accessed 30 October 2016) 1.
[91] OECD Development Co-operation Report 2016 The Sustainable Development Goals as business opportunities available at http://bit.ly/2enJsOF (accessed 30 October 2016) 302.
[92] Oguttu AW "Exposing and curtailing secret offshore tax shelters: the tools and the enablers. A call for vigilance in South Africa" (2011) 56-58.
[93] Ogley A (1990) 3.

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that individuals and companies are taxed on their world-wide income bases. Anti-tax avoidance provisions enable a country to guard against tax avoidance and evasion. This provision prevents resident taxpayers from deferring their domestic tax on foreign income by imposing a foreign company in a tax haven jurisdiction. It is evident that South Africa applies the OECD's recommendations.

4.3. Conclusion

Based on the abovementioned recommendations it is clear that although South Africa is not a member of the OECD, it has conformed itself to the application of the recommendations as set out in the 1998 report. Although the Promotion and Protection of Investment Bill and the Draft Financial Intelligence Centre Amendment Bill, 2015 referred are not legally binding yet, it is a clear indication that South Africa is well on its way towards combating harmful tax practices. In 2017 South Africa will be one of many other countries that implement an automatic exchange of information for tax purposes. This is the first step towards accessibility in ensuring that individuals and companies are not able to hide behind the secrecy provisions offered by banking authorities in tax haven jurisdictions. DIRCO helps South Africa to co-operate with African continents. This co-operation could very well contribute towards African countries providing transparency and effective exchange of information relating to tax.

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5. CONCLUSION

The OECD recommended that countries intensify domestic laws and rules in a manner that conforms with its recommendations and guidelines to curb harmful preferential regimes. South Africa has sufficient domestic laws and rules that are in line with the recommendations set out in the 1998 OECD report. Although the headquarter provision may contribute towards tax evasion and avoidance of non-residence into South Africa. South Africa needs to however monitor that these regimes do not eventually become harmful preferential regimes. With regards to transfer pricing, South Africa needs to create a legislation which ensures that section 31(2) of the Income Tax Act refers to the guidelines of the OECD. SARS interpretation note 7 which provides the guidelines is not legally binding and outdated. Measures need to be taken to ensure that it conforms with the revised guidelines. Prevention of treaty abuse is also one of the essential recommendations that South Africa has been attempting to prevent through DTA, GAAR, Substance over form provision, and Beneficial owner provisions in treaty. All these are in compliance with the OECD's recommendations. The concept of beneficial ownership needs to be enacted into legislation. It is not certain whether the FICA Bill will be enacted as it is the one which provides a clear and concise definition of beneficial ownership. South Africa has also re-negotiated its treaty with Mauritius which allowed for treaty shopping. South Africa should also re-negotiate other treaties with countries with zero or low withholding tax rates. DIRCO ensures that there is an intergovernmental co-operation between governments. The intergovernmental relations will enable sharing of information.

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