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A SOUTH AFRICAN PERSPECTIVE ON ACTION 6 OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT'S ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING

by

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ABSTRACT

Base erosion and profit shifting are a growing international concern, that was again ushered to the forefront following the 2008 financial crisis. In order to address this issue, the Organisation for Economic Co-Operation and Development ('OECD'), as mandated by the G20, developed the Action Plan on Base Erosion and Profit Shifting ('BEPS'). BEPS has identified 15 Actions ('the Actions') to address base erosion and profit shifting issues. Action 6 is titled: 'Preventing the granting of treaty benefits in inappropriate circumstances'.

To give effect to BEPS, the OECD drafted the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI'). On 7 June 2017, South Africa was one of more than seventy countries that signed the MLI.

There has been criticism against Action 6 of BEPS and the MLI, which ranges from a lack of participation by non-OECD members to the manner in which the MLI was drafted. Action 6 of BEPS must be considered from a South African perspective, by considering how Action 6 will likely affect the rights and obligations of developing countries. This consideration is motivated by observing the historical impact of the OECD Model Convention with regards to Taxes on Income and Capital ('MTC'), which has historically favoured developed countries over developing countries, by largely limiting sourced based taxation.

Accordingly, this perspective must consider whether Action 6 and the relevant sections of the MLI, which was drafted to address the purpose of Action 6, will be beneficial to South Africa and other developing countries.

The rationale for entering into a double taxation agreement ('DTA') might be wholly different from the perspective of a developing country. Despite the OECD's intention to address BEPS, the question arises whether the OECD is set on fairly and adequately addressing the BEPS issue.

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LIST OF ACRONYMS AND ABBREVIATIONS

15 Actions	the Actions
ATAF	African Tax Administration Forum
BEPS	Base Erosion and Profit Shifting
CFA	Committee on Fiscal Affairs
DTA	double taxation agreements
ECOSOC	Economic and Social Council
G20	Group of 20
GAAP	General Anti-Avoidance Provisions
GDP	Gross Domestic Product
GNI	Gross National Income
IMF	International Monetary Fund
ITA	Income Tax Act 58 of 1962
Mexico Convention	Model Convention of Mexico 1943
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
MNEs	Multinational Enterprises
MTC	Model Tax Convention
OECD	Organisation for Economic Co-Operation and Development
OECD/G20 BEPS	Organisation for Economic Co-Operation and Development/ Group of 20 Base Erosion and Profit Shifting Project
OEEC	Organisation for European Economic Cooperation
PE	Permanent Establishment
PPT	principle purpose test
SARS	South African Revenue Service
SLBP	Simplified Limitation of Benefits Principle
UN	United Nations
USA	United States of America
WEPS	World Economic Situation and Prospects
WW1	First World War
WWII	Second World War

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Chapter 1

1 Background

1.1 Introduction

The Organisation for Economic Co-operation and Development ('OECD'), emphasises that economies have become more globally integrated. As a result, Multinational Enterprises ('MNEs'), now represent a large portion of the global Gross Domestic Product ('GDP'). In the context of globalisation, a shift in country specific operating models to global operating models by businesses, can be observed. Consequently, tax planners more sophisticatedly identify and exploit the legal arbitrage opportunities of acceptable tax planning, with MNEs being more confident in adopting an aggressive tax planning attitude. As MNEs often exploit the differences in tax systems, MNEs have the opportunity to greatly minimise their tax burden.[1]

In the international tax environment, a number of countries have expressed their concern about how international standards, on which bilateral tax treaties are based, allocate taxing rights between source and resident states.[2] The OECD has recognised the need for fundamental changes in order to effectively prevent double non-taxation and prevent low or no taxation, associated with practices that artificially segregate taxable income, from the activities that generate it.[3]

1.1.1 Action plan on base erosion and profit shifting

In order to address this issue, the OECD as mandated by the G20, has developed the Action Plan on Base Erosion and Profit Shifting (BEPS). BEPS has identified 15 Actions ('the Actions') to address base erosion and profit shifting. These Actions are:

Action 1 – Addressing the tax challenges of the digital economy;

Action 2 – Neutralising the effects of hybrid mismatch agreements;

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1 OECD 'Action Plan on Base Erosion and Profit Shifting' available online at: http://dx.doi.org/10.1787/9789264202719-en (accessed 3 August 2019) 7-8.

2 OECD (n 1 above) 11.

3 OECD (n 1 above) 13.3.

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Action 3 – Designing effective controlled foreign company rules;

Action 4 – Limiting base erosion involving interest deductions and other financial payments;

Action 5 – Countering harmful tax practices more effectively, taking into account transparency and substance;

Action 6 – Preventing the granting of treaty benefits in inappropriate circumstances;

Action 7 – Preventing the artificial avoidance of permanent establishment status;

Action 8 –10 Aligning transfer pricing outcomes with value creation;

Action 11 – BEPS DATA analysis;

Action 12 – Disclosure of aggressive tax planning;

Action 13 – Transfer pricing documentation;

Action 14 – Dispute resolution;

Action 15 – Multilateral Instruments.

The purpose of this dissertation is to address Action plan 6, which relates to preventing the granting of treaty benefits in inappropriate circumstances. Before turning my attention to Action plan 6, Article 7 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting is discussed.

1.1.2 Article 7 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

Article 7 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI'), headed 'prevention of treaty abuse', provides for three different rules relating to treaty abuse and instances when the treaty benefits will not be applicable. Firstly, is the so-called 'principle purpose test' ('PPT'). In this regard Article 7(1) provides that:

> [N]otwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable

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> to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

The second concept which can be utilised, if the contacting state does not elect to apply the PPT, is that of Simplified Limitation of Benefits Principle ('SLBP'). Thirdly, should an election be made that SLBP will not apply to a covered tax agreement, the Contracting Jurisdictions shall consequently endeavour to reach a mutually satisfactory solution, which meets the minimum standard for preventing treaty abuse under the OECD/G20 BEPS package.[4]

South Africa intends to adopt the PPT as set out in Article 7 of the MLI, which is already the existing criteria in many tax treaties.[5] Article 7 of the MLI, will accordingly have to be considered in light of the General Anti-Avoidance Provisions ('GAAP'), contained in South African legislation. The GAAP are contained in Part 11A of the Income Tax Act 58 of 1962 ('ITA'), which encompasses section 80A-L of the ITA.

It is however important to note that Article 7 of the MLI denies the benefits derived from the treaty if one of the principle purposes of entering into a transaction is to obtain a treaty benefit. Opposed thereto is the domestic GAAP, which denies an avoidance in terms of an agreement if the sole or main purpose was to obtain a benefit. In the following paragraphs a comparison will be drawn as to the difference between these two concepts.

1.1.3 The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

In order to combat BEPS, the OECD drafted the MLI. On 7 June 2017, South Africa was one of more than seventy countries globally, to sign the MLI. As elaborated further in this discussion, the MLI contains specific articles, which are aimed at addressing the various action plans. Chapter III of the MLI, headed 'Prevention of Treaty Abuse'

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[4] OECD 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' available online at: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 3 August 2019) Chapter 7.

[5] Werksmans 'The Implementation of the BEPS Multilateral Instrument in South Africa' available online at: https://www.werksmans.com/legal-updates-and-opinions/the-implementation-of-the-beps-multilateral-instrument-in-south-africa/ (accessed 3 August 2019).

which encompasses Article 7, is aimed at addressing Action 6 of BEPS, dealing with the prevention of treaty benefits in inappropriate circumstances.[6] Action 6 further requires that the definition of Permanent Establishment ('PE'), be updated to avoid treaty abuse.

It has been suggested that the most far reaching Articles in relation to Action 6, for South African purposes, will be Article 4 and Article 7 of the MLI.[7] In order to illustrate this point, Article 4 of the MLI is subsequently discussed.

1.1.4 Article 4 of the MLI

Article 4 of the MLI, relates to the applicable provisions of dual resident entities. In terms of Article 4, should a person (other than an individual), be a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine, by mutual agreement, the jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to: its place of effective management; the place where it is incorporated or otherwise constituted; and any other relevant factors.

In the absence of such an agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement, except to the extent and in such manner as may be agreed upon by the competent authorities of the contracting jurisdictions.[8] It is noteworthy that Article 4 is not applicable to instances of an individual.

This is arguably in line with the focus that BEPS places on MNEs, by intending avoidance of treaty abuse by MNEs and juristic persons. Further, the considerations that have to be applied by the respective revenue authorities such as: encompassing place of effective management; place of incorporation; or where the entity is constituted, are considerations that cannot be applied to a natural person. Again, this demonstrates the emphasis placed on juristic entities and MNEs.

Article 4 of the MLI, therefore contains a new tie-breaker provision in instances where an entity is a dual-resident of more than one tax jurisdiction. Hence, the traditional

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[6] OECD (n 4 above) Chapter 3.
[7] Werksmans (n 5 above).
[8] MLI, Article 4.

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‘place of effective management’ rules are replaced. SARS and its foreign counterpart will thus have to come to an agreement on which country is the country of residence, and if no such agreement can be reached, the provisions of the treaty will not applicable in that instance. The place of effective management was previously the test utilised to determine the residence of the entity. According to article 4 of the MLI the place of effective management is now only considered to be one of the considerations that the relevant tax authorities must pay attention to.

Although the term ‘place of effective management’ is widely used in DTAs, as a tie-breaker provision, there is no uniform meaning on this term internationally. [9] Place of effective management in not defined in the ITA. SARS issued an interpretation note, wherein the position is taken that the place of effective management is the place where a company is managed on a regular or day-to-day basis, by the directors or senior managers of that company.[10] It is important to note that one of the factors to consider in accordance with Article 4, is still the place of effective management.

1.2 Research questions

The research questions identified, must be read in conjunction with the chapter outline referred to below:

1.2.1 The main research question is focussed on a critical evaluation of BEPS’s Action 6 and the MLI, as well as the effectiveness thereof to combat Tax Treaty Abuse.

1.2.2 Firstly, the historical development of the OECD and the manner in which the OECD developed its policies on international tax issues are explored. This is an important consideration in light of the apparent struggle between developed and developing countries in the context of tax income rights.

1.2.3 Secondly, the position of South Africa and other developing countries on BEPS and the MLI is discussed. This is evaluated in light of the fact that taxation is only one of the relevant factors which should be considered, especially by

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9 A Oguttu *International Tax Law: Offshore Tax Avoidance in South Africa* (2015) 78.
10 Oguttu (n 9 above) 87.

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developing countries, upon entering in DTAs and international tax instruments such at the MLI. Whether or not the MLI will address BEPS issues from the perspective of developing countries is also addressed under this research question.

1.2.4 The final research question is focussed on whether the MLI, in light of the above Article, will achieve its goal of effectively combatting Tax Treaty abuse and whether or not South Africa should have refrained from signing the MLI.

1.3 Research methodology

The methodology of this research is predominantly focussed on two aspects. The first aspect relates to a consideration of the current manner in which income is taxed between states, with specific consideration of the positions between developing and developed countries.

The second aspect considers whether South Africa should have rather refrained from signing the MLI, by carefully evaluating the realistic achievement of the goals, as set out in the MLI. As part of this consideration, the addressing of core issues relating to source and residence-based taxation is preferred to an attempted implementation of rules that potentially do not address BEPS concerns for both developed and developing countries.

1.4 Chapter outline and overview of chapters

Chapter 2 introduces the reader to the events leading to the development of the OECD and the manner in which the OECD engages in the drafting of tax policies. Chapter 3 addresses South Africa's position in relation to BEPS and the MLI. Issues of interpretation and BEPS from the perspective of a developing country are explored in this chapter. Chapter 4 considers the common forms of Tax Treaty Abuse and considers the South African General Anti Avoidance position in the context of tax treaty abuse. Chapter 5 concludes this research with a short reflection and comments on whether South Africa should have signed the MLI. In this conclusion some recommendations are given as to the way forward.

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Chapter 2

2 The Organisation for Economic Co-Operation and Development

2.1 Introduction

The OECD describes itself as an international organisation that endeavours to build better policies for better lives. Their goal is to shape policies that foster prosperity, equality, opportunity and well-being for all. Together with governments, policy makers and citizens, they work on establishing international norms and producing evidence-based solutions to a range of social, economic and environmental challenges.[11]

Upon considering the tax-policies enacted by the OECD from a South African perspective, a reflection of the historical context of the OECD is essential. The significance hereof is rooted in the plethora of perspectives from which these policies may be viewed. One perspective considers the interplay between developed and developing countries or economies and another perspective considers the concept of residence and source-based taxation. It is impossible to effectively consider these considerations without firstly understanding of the historical formation of the OECD and the foundation of its policies.

The concept of international taxation of income chiefly revolves around two main concepts. These are respectively: the concepts of residence and source-based taxation.[12] When a country's right to tax a taxpayer emanates from the fact that the taxpayer is considered to be a resident or has resident status, this is referred to as residence-based taxation. The taxation is accordingly based on the status of the person as a resident and typically the taxpayer will be taxed on its income, regardless of that income's source. Furthermore, the taxpayer will usually be taxed on its worldwide income, irrespective of the source of such income. In order to determine if

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[11] OECD 'About' available online at: https://www.oecd.org/about/ (accessed 14 July 2019).

[12] UN 'Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries' (June 2016) 1, available online at: https://publicadministration.un.org/publications/content/PDFs/E-Library%20Archives/2003%20Manual%20for%20the%20Negotiation%20of%20Bilateral%20Tax%20Treaties%20between%20Developed%20and%20Developing%20Countries.pdf (accessed 14 July 2019).

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a taxpayer is indeed a resident for purposes of taxation, consideration must be given to the domestic tax laws of each respective country. Domestic tax legislation may establish the basis for determination of the concept of 'resident' and 'residence'.[13]

Opposed thereto is the concept of source taxation. Under the 'source principle', tax is levied on income in a specific country, if it is considered that the source of the income is within that country. Similarly, the domestic tax laws of a specific country must be considered in order to determine whether or not the source of the income is indeed derived from the country. This will inevitably vary from country to county.[14]

Examples of source-based income may include instances where the income generating structure is located within a country. This may include various assets and business activities that ultimately give rise to the income. The extraction and mining of minerals, for example, would ordinarily be indicative of the nexus between the country and the source of the income and depending on the country specific laws and legislation, would be taxed on the source-based method.[15]

The United Nations ('UN'), in its World Economic Situation and Prospects ('WEPS') utilises a country classification system to classify countries worldwide, into one of three categories. These three categories comprise of developed economies, economies in transition and developing economies. One of the principal considerations utilised by the UN, as a measure to classify countries, is by their Gross National Income per capita ('GNI'), as established by the World Bank.[16] The World Bank, International Monetary Fund ('IMF') and other organisations, similarly employs GNI to classify the development of a country.[17] According to the UN WEPS South Africa is classified as a developing country.[18]

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13 OECD (n 11 above).

13 UN (n 12 above) 2.

14 OECD (n 11 above).

15 OECD (n 11 above).

15 UN (n 12 above) 2-3.

16 United Nations 'World Economic Situation and Prospects' (2019) 2 available online at: https:// https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/WESP2019_BOOK-web.pdf (accessed 14 July 2019).

17 World Bank 'Developed and Developing Countries: World Bank Classification Economics' available online at http://www.economicsdiscussion.net/economic-development/developed-and-developing-countries-world-bank-classification-economics/30010 (accessed 14 July 2019).

18 United Nations (n 15 above).

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Oguttu,[19] refers to the idea that since the inception of the development of DTAs by industrialised countries to prevent double taxation in the early twentieth century, there has been an ongoing struggle between developed and developing countries to ensure favourable taxing rights.[20] This is by virtue of the fact that each country will have different interests which underlies the motivation to protect their tax base.

Developed countries are generally capital exporting countries, whilst developing countries are ordinarily capital importing countries. Capital exporting countries (or the producers of capital), ordinarily derive revenue income from the value it adds during the production stage, which is accompanied by a sense of entitlement to the tax income or revenue derived by their residents in producing such capital. Consequently, when two countries enter into DTA negotiations, capital exporting countries are incentivised to negotiate the most beneficial terms for their residents, investing in offshore markets.[21]

The capital exporting country will contend for the lowest possible tax rates for its residents in the foreign jurisdiction, whilst attempting to tax and raise the majority of tax revenue within its own revenue system. On the other hand, capital importing countries derive revenue from taxing the income generated by sales activities, flowing from the foreign invested income within their country. Therefore, these capital importing countries are incentivised to ensure they receive their fair cut of the metaphorical revenue cake, because they provide the infrastructure that support these foreign investments in their domestic economies.[22]

Developing countries, often battle to preserve their right to tax source country income. If two countries enter into a DTA in terms of which each country gives up some of its jurisdiction to tax sourced based income, and the flow of income received from trade and investment are unbalanced (ordinarily developing countries and developed countries) the effect is often that there is a shift in revenue from the capital importing country to the capital exporting country. However, where there is a balance between

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19 A Oguttu 'A Critique of International Tax Measures and the OECD BEPS project in addressing fair treaty allocation of taxing rights between residence and source countries: The case of tax base eroding interest, royalties and service fees from an African Perspective' (2018) 29 *Stellenbosch Law Review* 314.

20 As above.

21 As above.

22 As above.

the flow of income from trade and investment (usually between two developed - capital exporting countries) it is usually of no moment, if each restrains its source jurisdiction to tax, as its residence taxation of income derived in the other country is correspondingly increased.[23]

2.2 Events leading to the development of the OECD

The first tax treaty was signed between Belgium and France on 12 August 1843.[24] During the beginning of the nineteenth century, various colonial powers expanded and endeavoured to increase their territories. Africa and Asia provided a source of natural resources and was a desirable prize for colonial powers. This led to an increase in conflict between different colonial powers. July of 1914 saw the outbreak of the First World War (WW1).[25] After the Allied forces emerged victorious from WW1, the League of Nations was established on 10 January 1920.[26] After the war, taxes, including income and corporate taxes, were increased to finance the rebuilding of various infrastructures etc. damaged during the war.

In order to counterbalance this, companies involved in significant international trade commenced with the development of schemes to reduce their tax liabilities. International trade was on the increase which was accompanied by more free flowing capital. This necessitated the development of domestic tax rules, including rules to prevent double taxation.[27] After appeals to the League of Nations, the League of Nations decided to take action, which then gave rise to the appointment of four economists known as the 'Committee of Technical experts on Double Taxation and evasion' in 1921. This committee was tasked with reporting on the economic aspects of double taxation.[28]

The League of Nations published the first international Model Tax Convention ('MTC'), dealing with double taxation in 1928. The MTC envisaged the equitable sharing of

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23 V Thuronyi *Tax law design and drafting international monetary fund* (1998) Chapter 18, 8. See also Oguttu (n 18 above) 318-319.
24 L Olivier & M Honiball *International Tax A South African Perspective* (2011) 268.
25 Indiana Department of Education available online at: https://www.doe.in.gov/sites/default/files/standards/guide.pdf (accessed 14 July 2019).
26 League of Nations Instituted available online at: https://www.history.com/this-day-in-history/league-of-nations-instituted (accessed 14 July 2019).
27 Oguttu (n 19 above) 318.
28 Oguttu (n 19 above) 318-319.

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taxes between residence and source-based taxing counties. The concept of source and residence-based taxing-countries are elaborated upon hereinabove.[29] The 1928 MTC saw the introduction of the so called 'Permanent Establishment' ('PE') concept. At its core, the PE concept envisages that taxation should not take place in source-based countries unless the enterprise has a significant and substantial economic presence in that country.[30] In terms of the 1928 MTC, the primary jurisdiction to tax residents was given to residence countries.[31]

The work on the MTC was set to continue, and in 1929 the Fiscal Committee of the League of Nations was formed to give effect thereto. The Fiscal Committee was represented by eleven countries. This comprised of nine representatives from developing countries (Argentina, Bolivia, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, and Venezuela) and two representatives from developed countries (Canada and the United States of America 'USA'). It is noteworthy to emphasise that there was more representative from developing countries, than developed countries.

On 1 September 1939 Germany invaded Poland, which sparked the beginning of the Second World War (WWII). The war was fought, predominantly across Europe and came to end some six years later on 2 September 1945 with Japan, the last of the Axis nations, surrendering.[32] Whilst WWII raged, the Fiscal Committee met in Mexico in 1940 and again in 1943 which culminated with the Model Convention of Mexico in 1943 ('Mexico Convention').[33]

The Mexico Convention differed from the 1928 MTC, by assigning taxing rights to the source county which favoured developing countries.[34] Many of the representatives of developed countries were unable to travel due to the raging WWII, which resulted in the Mexico Convention seeing less yielding of source-country revenue.[35] This position ultimately favoured the developing countries.

In 1945 the Fiscal Committee met with the League of Nations in London. By this time WWII was over and again the issue of international trade and taxation was in the

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29 See 2.1 above.
30 Oguttu (n 19 above) 318-319.
31 As above.
32 World War Two available online at: http://www.world-war-2.info/summary/ (accessed 14 July 2019).
33 Oguttu (n 19 above) 318-319. See also Olivier *et al* (n 22 above).
34 Oguttu (n 19 above) 320.
35 M Lennard 'The purpose and current status of the United Nations Tax work' *Asia-Pacific Tax Bulletin* (2008) 23.

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spotlight. Once again, Europe had to rebuild itself after the devastation of the war. Representatives of developed countries were no longer restricted in their movements, as was the case during the subsistence of the war. The so-called 'London-draft' was subsequently promulgated, which in turn overturned the Mexico Convention. This occasioned a reduction of source-country taxing rights and increased taxing rights for residence-based taxation. This approach again favoured the developed countries, which evidently desired to depart from the position enacted in the Mexico Convention. In terms of the London-draft, an enterprise which was resident in one country, had to have a permanent establishment in another country (source country), for that other country to tax any of its business profits.[36]

As will be elaborated upon hereinbelow, after the end of WWII, the League of Nations was dissolved and replaced by the UN. In 1948 the Organisation for European Economic Cooperation ('OEEC') was tasked with further development of the MTC. As indicated by its name, the OEEC was a representative of European countries and indeed represented all European countries at that stage.[37]

2.3 The development of the OECD Tax Treaty Policy

Post WWII Europe was emaciated by the devasting effects of the war. The USA was concerned about the possibility that the poverty and unemployment would sway European voters in favour of the communist doctrine. This led to the development of the Marshall Plan, which envisaged and eventually culminated in the distribution of economic aid to the value of thirteen-billion US dollars, to European economies in order to assist with the rebuilding Europe after the war. Sixteen European countries, consisting of: Austria; Belgium; Denmark (with the Faroe Islands and Greenland); France; Greece; Iceland; Ireland; Italy (and San Marino); Luxembourg; the Netherlands; Norway; Portugal (with Madeira and the Azores); Sweden; Switzerland (with Liechtenstein); Turkey; and the United Kingdom participated in the Marshall Plan.[38]

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36 Oguttu (n 19 above) 320.
37 As above.
38 The Marshall Plan and the establishment of the OEEC available online at: https://www.cvce.eu/en/education/unit-content/-/unit/55c09dcc-a9f2-45e9-b240-eaef64452cae/164c96b3-4d46-4c09-a177-2e6d35a832b2 (accessed 3 August 2019).

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These countries, led by Great Britain and France, established the OEEC in 1948.[39] The OEEC was created to implement and executed the Marshall Plan, for the reconstruction of Europe. In 1960 the USA, Canada and the OEEC members signed the OECD Convention, and the OECD was officially established on 30 September 1961.[40] When the OEEC became the OEDC in 1961, the main purpose of the OECD was to build strong economies for its member countries.[41] In 1963 the OECD published its first draft MTC, with the OECD's final MTC published in 1977. The final 1977 MTC was revised in 1992, 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010, 2014 and 2017 respectively.

Today the OECD consists of thirty-seven member states comprising of: Australia; Austria; Belgium; Canada; Chile; Czech Republic; Denmark; Estonia; Finland; France; Germany; Greece; Hungary; Iceland; Ireland; Israel; Italy; Japan; Korea; Latvia; Lithuania; Luxembourg; Mexico; the Netherlands; New Zealand; Norway; Poland; Portugal; Slovak Republic; Slovenia; Spain; Switzerland; Turkey; United Kingdom; and the USA.[42] The OECD currently have a number of 'key partners', which comprise of states that are non-members of the OECD, but which have an observer status. These countries participate in the OECD's daily workings and include countries such as South Africa, Brazil, China, India and Indonesia.[43]

The UN again became embroiled in international tax issues in 1967. As indicated the OECD model, then being developed predominantly favoured developed countries. The Economic and Social Council ('ECOSOC') of the UN contended that the UN, was the only truly global forum and that the UN consequently had the role of encouraging investment in developing countries. Investment in developing countries had to be conducted in a balanced way, that maintained adequate source country taxation rights over activities economically linked to that specific country.[44]

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[39] Marshall Plan available online at: https://www.britannica.com/event/Marshall-Plan (accessed 3 August 2019).

[40] OECD History available online at: http://www.oecd.org/about/history/ (accessed 3 August 2019).

[41] Oguttu (n 19 above) 320.

[42] List of OECD member countries available online at: https://www.oecd.org/about/document/list-oecd-member-countries.htm (accessed 3 August 2019).

[43] OECD 'Members and Partners' available online at: https://www.oecd.org/about/members-and-partners/ (accessed 3 August 2019).

[44] Lennard (n 35 above) 23

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In 1967 ECOSOC of the UN adopted a resolution which requested the Secretary General of the UN to develop and *ad hoc* working group consisting of experts in taxation and tax administrators, acting in their personal capacity (albeit that they were nominated by countries), to deal with tax treaties between developed and developing countries. This would come to fruition by consulting with international agencies, to explore ways and means of facilitating the conclusion of tax treaties between developed and developing countries. Accordingly, the Secretary General set up the *ad hoc* group of experts on tax treaties between developed and developing countries in 1968. The efforts of the *ad hoc* group spanned from 1968 to 1977, developing the guidelines for negotiating bilateral tax treaties between developed and developing countries. In 1979 the 'Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries' was published, which manual has later been updated. Following this, the group undertook work on a UN 'Model Double Taxation Convention'. The UN MTC was based on the 1977 OECD MTC.[45]

The draft model was adopted in 1979 and published in 1980. A new version of the UN model was published in 2001 with a new version of the manual published in 2003. [46] The last South African representative which served on the UN committee of experts was Mr Ron van der Merwe, a SARS official, until his recent retirement. South Africa currently has no representation on the UN committee of experts.

The UN model, which is widely considered to be more favourable to the rights of developing countries, is not free of criticism and is often criticised. Daurer criticises the UN model on the basis that it is not radical enough and does not consider the needs of developing countries sufficiently.[47] Rocha[48] contends that a scrutiny of history reveals the intrinsic connection between the development of international taxation and the development of income tax, along with the economic crises that have erupted over the years.

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45 As above.

46 As above.

47 V Daurer *Tax treaties and developing countries* (2014). See also F Krause *A comparative study of double tax agreements in a Southern African Context* Unpublished MCom dissertation, University of Pretoria (2015).

48 S Rocha 'Tax sovereignty in the BEPS era' (2017) 60 Kluwer Law International BV 181.

If one is to single out and consider the most important catalysts for the development of international taxation, the two world wars immediately comes to mind.[49] This contention is apparent from the discussion of the impact of the two world wars referred to hereinabove. It has been demonstrated how WWI was the predominant catalyst for the development of international taxation, whilst WWII was the catalyst for the creation of the OECD, which to a large extent impacts the manner in which DTAs are concluded to this day. Again, it would appear that history has repeated itself, with the latest changes and developments seen in international taxation being spurred on by the economic catastrophe, which took place during the 2008 financial collapse.[50]

The 2008 financial collapse may be attributed to numerous factors, but it did in fact force countries to critically reconsider the manner in which cross-border transactions are taxed. This perpetually led to the largest reaction to aggressive tax planning in history.[51] This critical reaction ultimately resulted in BEPS and the MLI. On request of the G20 finance ministers, the OECD was tasked with developing an action plan to address BEPS. It was envisaged that the action plan, should contain instruments that equip countries at a domestic and international law level, to better align the right to tax, with economic activity.[52]

In July 2013 the OECD Committee on Fiscal Affairs ('CFA') submitted the BEPS action plan to the G20, identifying fifteen Actions to address BEPS.[53] The G20 leaders endorsed the action plan in September 2013.[54] The CFA including OECD and G20 countries worked on the final BEPS package which came into fruition during 2015. Action 15 of the BEPS actions envisaged developing the MLI, to modify bilateral tax treaties swiftly, in order to implement BEPS measures in relation to tax treaties. In order to give effect to the development of the MLI, the OECD was tasked with developing the MLI. Any interested country could partake in the development of the MLI on an equal footing and participation was not reserved to member countries of the

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49 Rocha (n 48 above) 181.
50 Rocha (n 48 above) 182.
51 As above.
52 OECD (n 1 above) 11.
53 OECD 'Multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting information brochure' available online at: https://www.oecd.org/tax/treaties/multilateral-instrument-BEPS-tax-treaty-information-brochure.pdf (accessed 3 August 2019).
54 OECD 'Explanatory statement to the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting' available online at: https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 3 August 2019) 2.

OECD or the G20. The *ad hoc* committee was mandated to complete the MLI and have same available for signature by 31 December 2016. In total, ninety-nine countries participated in the drafting of the MLI.[55]

Of the ninety-nine countries participating, twenty-two of them were African Countries. The African countries were: Benin; Burkina Faso; Cameroon; Côte d'Ivoire; Democratic Republic of Congo; Egypt; Gabon; Kenya; Lesotho; Liberia; Mauritania; Mauritius; Nigeria; Senegal; South Africa; Sudan; Swaziland; Tanzania; Zambia; and Zimbabwe. Further, four non-state jurisdictions and seven international or regional organisations participated as observers, amongst these were the African Tax Administration Forum ('ATAF') and *Centre de recontres et d'etudes des dirigeants des administrations fiscales.*[56]

The *ad hoc* group concluded its negotiations by 24 November 2016 and the MLI text along with the explanatory memo was accepted.[57] By 31 December 2016, the date envisaged for the completion of the MLI, the MLI was opened for signature. All countries could join the MLI, including developing countries that were not part of the BEPS project. On 17 August 2017, a signing ceremony was held. South Africa along with ten other African Countries signed the MLI. In total seventy-one jurisdictions signed the MLI. It is noteworthy that the USA did not sign the MLI. Despite the fact that South Africa is a member of the G20, South Africa is not a member of the OECD. However, during 2007 the OECD adopted a resolution in terms of which South Africa is one of five appointed 'key partners' of the OECD. Key partners contribute to the work of the OECD in a 'comprehensive' and 'sustained' manner.[58]

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55 As above.

56 A Oguttu 'OECD multilateral instrument on treaty-related BEPS measures: Benefits, challenges and recommended options for South Africa and other developing countries' (2017) *South African Yearbook of International Law* 222.

57 OECD (n 53 above).

58 OECD 'South Africa and the OECD' available online at: https://www.oecd.org/southafrica/south-africa-and-oecd.htm (accessed 3 August 2019).

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Chapter 3

3 South Africa, BEPS and the OECD

3.1 An issue of interpretation

Upon exploring DTAs from a South African perspective, the legal status afforded to a DTA and how the terms of a DTA will be interpreted, must be carefully considered. Various different situations may arise which could in turn demonstrate the importance of this consideration. Firstly, there are instances where the domestic tax legislation in South Africa ascribes a certain definition to a term, where in terms of a DTA no corresponding definition is supplied. An example hereof is the term 'beneficial ownership', a term that is frequently incorporated in DTAs to which South Africa is a party.

'Beneficial ownership' is a term which is defined and consequently ascribed a certain meaning in terms of our domestic tax legislation, whilst not being specifically defined by the OECD MTC or in DTAs. Secondly, the situation may arise with reference to Article 7 of the MLI, where a provision is couched in much wider terms in a DTA, as opposed to in domestic legislation. The provision pertaining to the purpose for entering into a transaction is a good illustration. In terms of the MLI, treaty benefits will be denied if one of the purposes for entering into a transaction was to obtain a treaty benefit. In terms of South African domestic tax legislation, the benefits will only be denied if the principle or main purpose of entering into the transaction was to obtain the benefit. Formulated differently, the question may arise whether the status of treaties are equal to that of domestic tax legislation, or whether they have a special or higher status than domestic tax legislation.[59]

Upon considering any legislation from a South African perspective, the point of departure must invariably be the Constitution of the Republic of South Africa, 1996.[60] This is attributed to the fact that the Constitution is the supreme law of the land.[61] In relation to 'international law' the Constitution deals with the following:[62]

a) [S]ection 231- which deals with international agreements;

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59 Olivier *et al* (n 24 above) 303.
60 Constitution of the Republic of South Africa, 1996.
61 Constitution (n 60 above) sec 2.
62 Olivier *et al* (n 24 above) 303.

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b) Section 232-which deals with international customary law; and
c) Section 233- which deals with the application of international law.

Section 233 of the Constitution states that:

> [W]hen interpreting legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law.

Whilst Section 231(2) states that:

> [A]n international agreement binds the Republic only after it has been approved by resolution in both the National Assembly and the National Council of Provinces, unless it is an agreement referred to in subsection (3).

Section 108(2) of the ITA states that:

> [A]s soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act.

Article 26 of the Vienna Convention on the Law of Treaties,[63] headed *'Pacta sunt servanda'* states that:

> [E]very treaty in force is binding upon the parties to it and must be performed by them in good faith.

From the abovementioned it is evident that, once there has been compliance with section 231 of the Constitution and section 108(2) of the ITA, a treaty will be considered to be enacted in terms of the ITA and will have the same effect as any other section enacted in terms of the ITA. The MLI functions in such a manner that it modifies existing treaties between two or more contracting parties. Unlike an amending protocol which would directly amend the text of a covered tax agreement, the MLI will be applied alongside existing tax treaties to modify their application. Consequently, it is not a pre-requisite that a consolidated version of the Covered Tax Agreement, as amended by the MLI be prepared, in order for the provisions of the MLI to apply.[64]

63 The Vienna Convention on the Law of Treaties was signed by the treaty parties on 23 May 1969 and came into effect on 27 January 1980.
64 OECD 'Explanatory statement to the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting' available online at:

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Consequently, a treaty does not have a higher or superior status to domestic legislation under South African law.[65] Section 108(2) of the ITA provides no assistance in the event of conflict between domestic legislation and treaty provisions.[66]

Olivier & Honiball refers to numerous considerations that are of importance when interpreting treaty provisions *vis-a-vie* domestic tax legislation. Firstly, they contend that the main objective of a tax treaty, in general, is to avoid the same income being taxed twice, as it follows that any domestic legislation which causes the same income to be taxed twice, must be interpreted as subordinate to the treaty provisions.

This view is supported by section 108 of the ITA, which specifically caters for scenarios to reduce or prevent double taxation. To adopt a view that the treaty does not apply when income tax is imposed in terms of domestic legislation, or to conclude that the treaty provisions will not override the domestic provisions, will lead to an absurdity, because it will invalidate the treaty provisions and give rise to taxation which the treaty specifically attempts to avoid or mitigate.[67] Furthermore, South African courts are bound by section 233 of the Constitution to follow for an interpretation which is consistent with international law.[68]

A tax treaty is the outcome of negotiations (between states) unlike domestic legislation which is not necessarily the product of international negotiations. Accordingly, in line with the *pacta sunt servanda* principle, tax treaty provisions should prevail over domestic legislation.

Be that as it may, the starting point for interpreting treaty provisions should be the domestic principles of interpretation. This is by virtue of the fact that from a South African perspective, the treaty provisions will form part of the domestic legislation in accordance with section 108(2) of the ITA, and further it will ordinarily be a domestic court tasked with interpreting the legislation.[69] The starting point for domestic interpretation and international interpretation will be the same. This manner of interpretation is premised on the so called 'ordinary meaning' of interpretation.

https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 3 August 2019) 3.

65 Olivier *et al* (n 24 above) 303.

66 As above.

67 Olivier *et al* (n 24 above) 304-305.

68 Olivier *et al* (n 24 above) 306.

69 As above.

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Interpretation can however not be confined to only the domestic principle, due to section 233 of the Constitution. A further consideration is that domestic interpretation varies from country to country and accordingly reliance cannot solely be placed on domestic interpretation when considering an international instrument. Should the domestic interpretation, through the application of the 'ordinary meaning' method of interpretation, be implemented and the ordinary meaning is clear, it will not be necessary to place reliance on 'international interpretation'. A treaty remains an international agreement irrespective of the fact that it is 'enacted' as part of the domestic legislation. International interpretation rules will consequently find application. One of the predominant international instruments utilised for interpretation is the Vienna Convention on the Law of Treaties. Reference has already been made to the fact that the South African Courts are constitutionally bound to follow an interpretation that is consistent with international law. South Africa is not a signatory to the Vienna Convention, however, the Vienna Convention is to a large extent a codification of the international customary law and South African courts are accordingly bound to take cognisance of its provisions.[70]

Article 31 of the Vienna Convention is considered a codification of the international position in relation to interpretation of treaties. In summary, Article 31 of the Vienna Convention stipulates that treaties must be interpreted in good faith, given the ordinary meaning of terms, taking into account the text, and context of a treaty. A special meaning may be ascribed to a term, if it is established that this was the intention of the parties.[71]

Despite the fact that South Africa is not a member of the OECD, the South African Courts have accepted that the OECD commentary may be used in interpreting tax treaties.[72] South Africa, like many other countries, apply the OECD commentary in the process of interpretation. This is consistent with Article 32 of the Vienna Convention. It must however be emphasised that under Article 32 of the Vienna Convention, the OECD guidelines will in all likelihood be seen as a supplementary means of interpretation, only to be utilised when a clear meaning in accordance with Article 31 cannot be distilled. Internationally, there is however no uniformity as to the status that

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70 Olivier et al (n 24 above) 307.

71 Olivier *et al* (n 24 above) 308.

72 *Secretary for Inland Revenue v Downing* 37 SATC 249.

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must be ascribed to the OECD guidelines.[73] Some authors describe the OECD guidelines as an expert opinion[74] whilst others have described it as a quasi-political statement.[75]

Should the conflict persist, and no solution be obtained under the international rules of interpretation, then consideration will have to be given to the South African common law rules of interpretation. This endeavour will commence with a literal interpretation seeking the legislature's intention in the words used.[76] From the above-mentioned discussion it is evident that interpretation of treaty provisions are somewhat complicated and may possibly amount to a protracted exercise.

Whilst the interpretation and process of interpretation of treaties is of great importance, the content and the development of the content that actually needs to be interpreted must be on the forefront of considerations for developing countries.

3.2 BEPS from the perspective of a developing country

The endeavours by the OECD to address BEPS as a global problem is praiseworthy. However, as illustrated above, the OECD has historically been aligned to the interests of developed countries. The OECD is at its core, not some independent organisation but is indeed, an organisation which is a representative of its member countries.

For this reason, the approach adopted by the OECD will consequently be a reflection of the agenda of its member states. This leads to the question of whether the approach followed by the OECD could possibly be considered in an independent context from the interest of its member states.[77] Taking into account the member countries that formed the OEEC, and the purpose for which the OEEC (and later the OECD) was established, it follows that the OECD is aligned to accommodate the interest of developed countries.

The BEPS project and the MLI have consequently come under scrutiny by voicing concerns of apprehension, predominantly from developing countries. This point is

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[73] Olivier *et al* (n 24 above) 312.
[74] Olivier *et al* (n 24 above) 313. See also J Van Brunschot 'The judiciary and the OECD MTC and its commentaries' (2005) *European Taxation* 7.
[75] Olivier *et al* (n 24 above) 313. See also N Shelton *Interpretation and application of Tax Treaties* (2004) 279.
[76] Olivier *et al* (n 24 above) 316.
[77] Rocha (n 48 above) 183.

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further discussed in the following paragraphs. If developing and developed countries have opposing approaches regarding the requirements for assigning tax rights in the international arena and the International Tax Reform is led by the OECD and developing countries, the concern of developing countries that the reform might be implemented to benefit the developed countries to the detriment of developing countries, is justified.

The timeframe for the drafting of the BEPS agenda from 2013 to 2015 was indeed expeditious. The tempo at which BEPS was drafted and implemented has, in itself, been criticised and raises the question whether true consensus had been reached between the states. This is attributed to the rate at which various drafts were finalised within the limited time for public comments, considering the plethora of issues addressed in BEPS.[78] It has been suggested that despite the political motivation of the G20 to address BEPS, the BEPS project has been wholly created within the OECD and that it is consequently more accurate to refer to the project as the 'OECD BEPS Project' rather than the 'OECD/G20-BEPS Project'.[79]

Brauner[80] contends that the OECD was charged by the G20 to develop BEPS, with virtually no supervision beyond the highest political levels. Further, it is proposed that the OECD has taken ownership of the BEPS project and has succeeded in positioning itself as an independent partner to the G20, as opposed to acting in a subordinate role.[81] Christian[82] notes that Europe and the USA virtually dominate tax policymaking and that this is achieved by utilising the OECD, which is an international conglomerate of thirty of the world's wealthiest countries.

The inclusion of the G20 under the mantle of the OECD does not derive from the position which Europe and the USA command, but rather creates new opportunities to market the OECD as a more inclusive framework. Christian continues to explain that the 2008 financial crisis might have elevated the voice of the G20 countries, but

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78 S Fung 'The questionable legitimacy of the OECD/G20 BEPS Project' (2017) *Erasmus Law Review* 76.

79 Rocha (n 48 above) 183.

80 Y Brauner 'Transfer Pricing Aspects of Intangibles: The Cost Contribution Arrangement Model' M Lang, A Storck & R Petruzzi (eds.) 'Transfer Pricing in a Post-BEPS World' *Kluwer Law International BV* (2016) 100.

81 Rocha (n 48 above) 183.

82 A Christians 'Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20' (2010) 5 1 *Northwestern Journal of Law & Social Policy* 19-20.

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that they will not necessarily provide the same for developing countries. Christian however concedes that the G20 may play a more pivotal role in future by addressing the concerns of developing countries and provide an institutional infrastructure from which developing countries can exert more pressure on the OECD.[83]

The fact that the US is the largest contributor to the budget of the OECD, has placed it in a position where it can exert pressure on the OECD with regards to policy making within the OECD.[84] The criticism of the OECD has gone as far as to elicit terms such as 'international tax imperialism'.[85] This notion, suggests that to export an 'international tax regime' to developing countries may be regarded as a form of international tax imperialism. The concept of international tax imperialism represents a situation where there is a transformation of certain tax criteria that favours developed economies into international tax standards. Hence, these international tax standards are, in turn, considered to be the basic principles of international taxation.[86]

The MLI is formulated in such a fashion so that it may be applied to all DTAs, whether they are based on the OECD MTC or the UN MTC. Notwithstanding this, developing countries might be hesitant to accept the MLI, by virtue of the fact that many developing countries had little, or no, involvement in the BEPS project.[87] Despite this and the considerable cost of implementation, fiscal sovereignty concerns, the possible biased application and the questionability of effectiveness, this has not discouraged countries from committing themselves comprehensively to the BEPS project.[88] Much like the aftermath of two world wars was a catalyst for tax treaty development, it appears that BEPS was created in the eye of a perfect storm, which propelled countries to join the BEPS project.[89] This perfect storm was to a large extent fuelled by the global financial crisis, a series of tax scandals, extensive media coverage of these events, civil lobbying, protests and parliamentary hearings.[90]

The OECD has been criticised for failing to address the issue of fair allocation of tax rights in BEPS. The fair allocation of tax rights is a fundamental issue, which lies at

83 Christians (n 82 above) 19-20.
84 Fung (n 78 above) 83.
85 Rocha (n 48 above) 188.
86 Rocha (n 48 above) 188.
87 Oguttu (n 56 above) 223.
88 Fung (n 78 above) 78.
89 Fung (n 78 above) 79.
90 As above.

the heart of the diverging interests of developed and developing countries. The failure to adequately address this perilous issue in BEPS has been branded as a missed opportunity.[91] India was one of the countries that publicly criticised the OECD for failing to address the real BEPS issues, by merely addressing superficial issues, whilst sweeping the substantial, factual and relevant issues under the rug. In essence, India implored the UN to take the interests of developing countries into account when addressing BEPS issues.[92]

As indicated, the UN MTC favours capital-importing countries as opposed to capital exporting countries by generally imposing fewer restrictions and limitations on the tax jurisdiction of source-based countries. This results in capital-importing countries generally favouring the UN MTC as opposed to the OECD MTC.[93]

[91] Oguttu (n 19 above) 326.
[92] Fung (n 78 above) 79.
[93] Oguttu (n 56 above) 223.

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Chapter 4

4 Tax treaty abuse

4.1 Conduct amounting to abuse

One of the main functions of tax treaties are to eliminate double taxation. This principal objective is ordinarily encompassed in the treaty title or preamble.[94] Tax treaties are aimed at relieving double taxation that may occur between various states, dependant on the base of their taxation i.e. source or resident based. Treaties endeavour to: alleviate double taxation between a residence and residence-based conflict; or a source and residence-based conflict; but not source and source-based conflict.[95] Thus, in the absence of a DTA in place, a company may be considered a resident of two jurisdictions simultaneously, which both employ resident based taxation, and consequently, as a resident of both jurisdictions, be taxed in both jurisdictions. Alternatively, it may be that the taxpayer is taxed on its worldwide income in its residence-country, and further be liable for tax based on the source-country where the income is generated.

Double taxation can be classified into two categories. The first being 'juridical double taxation'. This is the case where two jurisdictions impose the same or similar taxes on the same taxpayer for the same period in respect of the same taxable income. Opposed thereto is so called 'economic double taxation', where two tax jurisdictions impose tax on the same taxable income, but in the hands of different persons.[96]

Double taxation can be detrimental to international trade, capital flow and profitable delivery of goods and services. A taxpayer that is taxed on the same income twice, may be demotivated to partake in international trade, as its profits will be greatly diminished by the burden of double taxation. It is thus evident that the facilitation of effective international trade, capital flow and profitable delivery of goods and services is another objective of tax treaties. There are numerous additional objectives of tax treaties.[97] Some of the other principal objectives of tax treaties include: the promotion

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94 Olivier *et al* (n 24 above) 276.
95 Olivier *et al* (n 24 above) 377.
96 Oguttu (n 9 above) 577.
97 Olivier *et al* (n 24 above) 303.

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of certainty to taxpayers (specifically demarcating the boundaries of taxpayers in the international arena) in order to facilitate the exchange of information and cooperation between tax jurisdictions in order to curb tax-evasion and to prevent treaty shopping; and the settlement of disputes through a mutual agreement procedure.[98]

From the abovementioned it is clear that tax treaties primarily endeavour to address and avoid double taxation. For treaties premised on the OECD MTC, there are two principal methods utilised to prevent the double taxation of income. These are referred to as the 'exemption method' and the 'credit method'. When applying the exemption method, the taxpayer's country of residence will levy domestic taxes on the taxpayers domestic-source income, whilst exempting the taxpayer from paying taxes on foreign source income.

When applying the credit method, the taxpayer's country of residence will generally reduce the domestic taxes payable by a taxpayer with an amount equal to that which the taxpayer paid on foreign source income. This can be illustrated as follows: Taxpayer X earns income from a foreign source of income in country-Y and is taxed on its earnings in the amount of R10.00. As a resident of country-X, X is liable to pay tax on the same earnings in the amount of R50.00. Because X has already paid R10.00 in country-Y, in the credit method applied, X will only pay R40.00 in country-X.

Oguttu refers to the fact that foreign-source income is in effect subject to the domestic tax whenever the foreign tax is less than the domestic tax rate.[99] Olivier and Honiball make reference to the fact that such tax treaty credit paid, is limited to the domestic tax liability in respect of the same foreign income and there is no possibility of a refund or utilisation of any excess, unless the relevant treaty specifically provides therefore. The deduction may not exceed the part of the income tax or capital tax, as computed before the deduction is given, which is attributed to the income or capital which may be taxed in that other state.[100]

Despite the objective of tax-treaties, they do give rise to opportunities to be exploited for tax avoidance purposes.[101] In this context, there is no universal legal or academic

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98 Olivier *et al* (n 24 above) 278.
99 Oguttu (n 9 above) 577.
100 Olivier *et al* (n 24 above) 463.
101 Oguttu (n 9 above) 577.

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definition of tax avoidance.[102] Terms like 'tax mitigation', 'tax avoidance' and 'tax evasion' are often used interchangeably and with varying meanings.[103] Tax evasion predominantly refers to some distortion of the truth, or a concealment of the true facts. This is akin to a tax fraud or criminal activity, with some element of falsehood. On the other hand, tax avoidance is a scheme or arrangement, which is implemented within the letter of the law, to receive some tax reduction or benefit. This conduct is not considered as criminal activity, but it is perceived as being contrary to the purpose of a legal principle.[104]

In addressing the prevention of the granting of treaty benefits in inappropriate circumstances, as contained in Action 6, the OECD distinguishes between two scenarios:[105]

a) Cases where the person attempts to circumvent the provisions established by the treaty itself ('Category one transactions');
b) Cases where a person tries to circumvent the provisions of domestic tax law by utilising treaty benefits ('Category two transactions').

The OECD further contends that in relation to category one transactions, because the intention is to circumvent tax treaty specific rules, it is unlikely that domestic anti-avoidance rules alone will adequately address such situations. Consequently, a more satisfactory approach is required by drafting anti-avoidance rules which form part of the treaty itself. In category two transactions, the avoidance is aimed at circumventing domestic anti-avoidance rules and cannot be addressed by solely relying on the provisions of a tax-treaty. Invariably, category two transactions raise the issue of the interplay between tax treaties and domestic anti-avoidance provisions.[106]

Category one transactions predominantly entail 'treaty shopping cases' and 'rule shopping cases'.[107] The provisions of tax treaties and the benefits possibly derived therefrom is ordinarily only available to the residents of the respective contracting

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102 M Gomes 'The DNA of the principal purpose test in the multilateral instrument' (2019) 47(1) *Intertax* 69.
103 As above.
104 As above.
105 OECD/G20 'Preventing Granting Treaty Benefits in Inappropriate Circumstances Action 6: 2015 final report' (2015) 17available online at: https://www.oecd.org/tax/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm (accessed 3 August 2019).
106 As above.
107 L De Broe & J Luts 'BEPS Action 6: Tax Treaty Abuse' (2015) 43(2) *Intertax* 125.

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states of the treaty. A tax avoidance scheme that is often implemented within the ambit of tax treaties is treaty shopping.[108] This envisions a situation where a resident of a non-treaty country utilises a tax treaty in order to obtain treaty benefits, to which it is not entitled. This scheme is ordinarily facilitated by incorporating a conduit company in a jurisdiction that has a bilateral treaty with a specific country, with the purpose of obtaining treaty benefits that the taxpayer would ordinarily not be entitled to.[109]

These conduit companies are often incorporated in so called tax-haven jurisdictions, referring to countries where the tax rate there is minimal.[110] These conduit companies act as an intermediary and they often have very limited powers. They perform the task of holding assets or rights as a nominated agent for another company. The benefit is consequently derived from the fact, that as a 'resident' of one of the contracting jurisdictions, it becomes entitled to favourable tax treaty terms and is empowered to shift profits away from treaty countries. A simple example to illustrate this is: Xco is a company incorporated in country A. It is desirous of expanding its business operations in country B. However, there is no existing tax treaty between country A and B. Country C, however, has a tax treaty in place with country B. In order to benefit from the treaty provisions of country B, Xco incorporates a conduit company in country C, in order to derive benefits from the tax treaty between countries A and C.

Oguttu refers to the fact that it is not only the absence of a tax treaty between two jurisdictions that can incentivise treaty shopping, but also the fact that there might be a more beneficial treaty between two countries, of which the taxpayer is not a resident, and this incentivises the taxpayer to get involved in treaty shopping arrangements.[111] Rule shopping cases typically envisage situations where a person is entitled to the treaty benefits, but set up in such a way that he is entitled to a more favourable rule within the treaty.[112]

De Broe and Luts contends that category one transaction are comprised of the following elements:[113]

a) A taxpayer is subject to a domestic provision, which give rise to a tax liability;

108 Oguttu (n 9 above) 549.
109 Oguttu (n 9 above) 549.
110 As above.
111 As above.
112 De Broe *at al* (n 107 above) 4.
113 As above.

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b) A taxpayer (improperly) invokes the benefit of higher-ranking tax treaty provisions to avoid that tax liability to arise.

Opposed thereto, category two transactions comprise of scenarios where domestic anti-avoidance principles are circumvented by the use of treaty benefits. These types of transactions ordinarily originate where the taxpayer will utilise strategies to inflate tax deductible expenses and/or shift taxable income to tax friendly environments (through transfer mispricing, excessive borrowing and the likes).[114]

In essence, these strategies cannot be factually classified as 'treaty abuse'.[115] In terms of category-two transactions, a state has enacted domestic anti-abuse legislation to combat domestic avoidance strategies. The taxpayer then endeavours to rely on treaty provisions and the *pacta sunt servanda* principle in order to neutralise the application of the domestic rules.[116] The Latin term *pacta sunt servanda* refers to the principle that agreements must be kept or honoured. Because tax-treaties are at their core an agreement between contracting states, there is an expectancy that such agreements must be honoured, and accordingly 'outrank' domestic legislation.

De Broe and Luts[117] further contend that category-two transactions ordinarily comprise of the following elements:

a) The taxpayer will place himself, in an improper manner, beyond domestic provisions that creates a tax liability or he places himself, in an improper manner, under a domestic provision that reduces his tax burden;
b) The relevant state then introduces or invokes a domestic anti avoidance doctrine or provision, in order to address the taxpayer's behaviour;
c) The taxpayer then endeavours to render the domestic anti-abuse doctrine ineffective, by relying on the benefits of a higher-ranking tax treaty.

Prima facie, category-one and category-two transactions appear to be similar, in that the ultimate result thereof is that domestic provisions creating a tax liability is set aside. However, upon consideration of the object of abuse, it becomes apparent that these two categories of transactions are dissimilar. In category-one transactions the abuse occurs in the second element (element b hereinabove). In such an instance the taxpayers conduct is to obtain the treaty benefit, and the object and the purpose of

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114 As above.
115 As above.
116 As above.
117 As above.

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those treaty benefits would be frustrated, if these benefits would be granted under those circumstances. In category-two transactions the conduct of the taxpayer is motivated by his desire to avoid a domestic tax provision. Consequently, the object and the purpose of those domestic provisions would be frustrated if these benefits would be granted in the circumstances.[118]

Accordingly, the position of the OECD in relation to the tax avoidance and the purpose of tax treaties, developed as time progressed. It is noted from the OECD commentary on the MTC that, from 1977 to 2003, the principal task assigned to tax treaties was to prevent double taxation and foster international trade. Reference is made to the fact that tax treaties should not promote or foster tax avoidance, but this appears to be a secondary consideration.[119] The task of combatting tax avoidance was placed on the domestic legislature and the domestic legislation of respective countries.

In the 2003 OECD MTC commentary on the improper use of tax treaties and the interplay between tax treaties and domestic legislation, saw a dramatic shift in the approach or position as adopted by the OECD. De Broe and Luts refer to six significant changes evident from the 2003 commentary, which are:

a) For the first time the prevention and avoidance of tax evasion, is elevated to a self-standing objective of tax treaties;
b) The relevant sections stipulating that anti-abuse provisions should be contained in tax treaties is simply left out of the 2003 commentary;
c) The OECD described two fundamental issues involving tax treaties and anti-avoidance, namely whether treaty benefits must be granted when transactions constitute an abuse of the particular treaty and whether specific provisions or jurisprudential rules of domestic law that are intended to prevent tax avoidance conflict with tax treaties;
d) The commentary contends that there is no conflict between GAARs and tax treaties. GAARs rules are there to determine which facts gave rise to a tax liability, these rules are not affected by tax treaties nor are they addressed in tax treaties;
e) The OECD fails to provide a definition of abuse but does for the first time offer a 'guiding principle'. According to the guiding principal a specific set of facts would constitute 'abuse' if: '[a] main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position" and "obtaining that more favourable treatment in these circumstances would be contrary to the object and the purpose of the relevant provisions'.

118 As above.
119 As above.

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f) Just because domestic GAARs might prohibit treaty benefits, if they are applied, does not mean that treaty provisions aimed at preventing abuse are unnecessary.

Despite the developments and the 2003 commentary, the fact that Action 6 is part of the BEPS action plan implies that OECD recommendation were not accepted by many countries, who found these provisions unsatisfactory.[120] Yet, in the eye of the perfect storm, Action 6 of BEPS was accepted as part of the BEPS Actions. Again, considering these provisions from a South African and indeed a developing countries perspective, raises a number of contentious considerations.

4.2 South African GAARS

The South African GAARs are contained in Section 80A-80L of the ITA. These provisions are applicable to transactions or arrangements that took effect on or after 2 November 2006.[121] According to section 80A of the ITA, an avoidance arrangement is an impermissible avoidance arrangement if its 'sole' or 'main' purpose was to obtain a tax benefit and:

a) [I]n the context of business:
   (i) It was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or
   (ii) It lacks commercial substance, in whole or in part, taking into account the provisions of Section 80C
b) In a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or
c) In any context-
   (i) It has created rights or obligations that would not normally be created between persons dealing at arm's length; or
   (ii) It would result directly or indirectly in the misuse of the provisions of the Act.

A number of concepts warrants further elaboration. According to section 80L of the ITA, an 'arrangement' is defined to include any of the following: any transaction; operation; scheme; agreement or understanding (whether enforceable or not); including all steps therein or parts thereof; and includes any of the aforementioned involving the alienation of property. For purposes of section 80A-80L 'tax' is defined to

[120] As above.
[121] Oguttu (n 9 above) 1050.

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include any tax, levy or duty imposed by the ITA or any other Act administered by the commissioner, whilst a tax benefit includes any avoidance, postponements or reduction for liability for tax. Section 80G of the ITA creates a so-called 'presumption of purpose'. This refers to the presumption that an avoidance arrangement is entered into for the sole or main purpose of obtaining a tax benefit unless, and until the party obtaining the tax benefit proves that reasonably considered, in light of all the circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

A comparison of the provisions of Article 7 of the MLI and the South African domestic GAARs illustrates a clear contrast regarding the purpose for entering into an arrangement. For the domestic GAARs to be applicable it must be established that the sole or main purpose for entering into the arrangement was to obtain the tax benefit. Opposed thereto, Article 7 of the MLI finds application where one of the principal purposes was to obtain a treaty benefit. The fact that a treaty benefit will be denied if one of the principle purposes was to obtain a treaty benefit, as opposed to the sole or main purpose, is a topic of much contention and debate.

This provision of Article 7 of the MLI has been widely criticised and it has been described as being fundamentally unacceptable.[122] Tax treaties are entered into for economic reasons, they aim to abolish tax restrictions, on the free movement of services, goods, capital and other commodities between countries.[123] The abolishing of tax restrictions in the above scenarios will inevitably contribute to international trade, and treaties encourage transactions that would ordinarily not have transpired if it had not been for the treaty.[124]

Tax is one of the most significant business costs that any business faces. To effectively and profitably conduct a business, consideration must be given to tax implications. Any competent businessperson must take into account the effect that tax will have (or has) on their business. This consideration, again, extends even further in the context

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122 De Broe *at al* (n 107 above) 131.
123 P Baretto & C Takano 'The prevention of tax treaty abuse in BEPS Action 6: A Brazilian perspective' (2015) 43(12) *Intertax* 826.
124 De Broe *at al* (n 107 above) 131.

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of developing countries.[125] Again, it appears that when Article 7 of the MLI was drafted, sufficient consideration of the position of developing countries was unsatisfactory.

A developing country may be incentivised to tolerate or even encourage treaty shopping. A developing country might be encouraged to offset the loss of tax revenue against the benefits that treaty shopping will provide, against long- and medium-term non-tax benefits it seeks to gain. The sacrifice of tax revenue might be insignificant against the benefits of attracting technology, foreign investment and development into the country.[126] Baretto and Takano contend that the granting of treaty benefits to a person not entitled thereto, who utilises a genuine and productive entity, is not contrary to tax treaty objectives and purposes, and cannot be deemed as treaty abuse if the result is the attraction of investment and technology.[127]

This view has been supported in the Supreme Court of India,[128] where it was held that as developing countries are dependant, foreign investment and treaty shopping is a relevant consideration that can attract foreign investment. It indeed appears that it is again a limitation imposed by developed countries on developing countries which can curb their economic development in an unacceptable manner. Be that is it may, there is no denying the fact that tax treaties do create possible scenarios that will constitute an abuse of tax treaties, and the international tax system, in which case the denial of treaty benefits is justified and appropriate. There must consequently be a distinction between a taxpayer that conducts a properly constituted and legitimate business and those premised on manipulating the system through artificial arrangements.

Yet, despite the aforementioned it appears that considerably less consideration was afforded to developing countries when drafting Action 6 of BEPS. Considering the history, purpose and the style of drafting MTCs by the OECD this is not surprising. However, despite adequate GAARs in domestic legislation, South Africa like many other developing countries hastened to join the BEPS project and sign the MLI. This can possibly give rise to interpretation issues and impact economic development in South Africa. Despite this possibility, South Africa is now part of the new dispensation

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125 Baretto *et al* (n 123 above) 826.
126 Baretto *et al* (n 123 above) 827.
127 Baretto *et al* (n 123 above) 828.
128 *Union of India and another v Azadi Bachao Andolan and another* 2003-(263)-ITR-0706-SC.

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of countries that signed the MLI. Chapter 5 will comprise of certain recommendations and conclusion.

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Chapter 5

5 South African observations and conclusion

5.1 Should South Africa have signed the MLI?

Despite being one of the Countries to sign the MLI, the question can be raised whether South Africa should have refrained, at least for the time being, from signing the MLI. This is indeed a difficult consideration, partially so, because of the fact that BEPS is Counterfactual, in other words it is unclear what the current international tax landscape would have been in the absence of the OECD actions on BEPS, and the MLI.[129]

On a very basic level, entering into tax treaties is indicative of a countries willingness to adopt international norms. This in itself can boost investor confidence in developing countries.[130] It is submitted that a similar argument is to be made in respect of signing the MLI. Considering the tempo at which BEPS was implemented and drafted, the number of countries that rushed to sign the MLI, and South Africa's involvement in the process, there was undoubtedly some element of displaying South African's aptitude to be seen as willing to adopt international norms and be considered a 'team player'. It can be contended that under the current wording and operation of the OECD MTC, the OECD MTC assigns taxing rights without obliging the State to effectively exercise those taxing rights.[131] By virtue of the aforegoing it cannot be argued that preventing double non-taxation is an objective of tax treaties.[132] However, under the MLI it will be specifically stated that the purpose of a treaty is to prevent double non-taxation, and same must then, in Accordance with Article 31 of the Vienna convention be interpreted in such a fashion, and consequently benefits must be denied in such a circumstance. The question will invariably remain, whether the treaty terms are couched in such a fashion to constitute the objective to prevent tax avoidance.[133]

Developing countries arguably have more at stake in an effective international tax system as their development depends on it.[134] South Africa was awarded observer

129 E Zolt 'Tax Treaties and Developing Countries' (2018) *Oxford University Centre for Business Taxation* Working Paper Series 41.
130 Thuronyi (n 23 above) 8.
131 De Broe at al (n 107 above) 142-143.
132 As above.
133 De Broe at al (n 107 above) 142-143.
134 A Oguttu 'Tax base erosion and profit shifting in Africa part 1: Africa's response to the OECD BEPS action plan' (2016) *International Centre for Tax and Development* 12.

status and participated in the BEPS process, therefor increasing the likelihood of thus signing the MLI. Despite the criticism levelled against the OECD BEPS project and pointing out the shortfalls by the OECD, in order to address the fundamental issue of source and residence-based taxation, Oguttu contends that it is important for developing countries to sign the MLI.[135]

Oguttu[136] opines that the following good reasons exist for developing countries to sign the MLI:

i. The MLI provides an easy and most cost-effective manner to update treaties, as opposed to the bilateral renegotiation of treaties, which would be time consuming, costly, and create uncertainty due to the non-uniformity and the bilateral nature of treaties;
ii. The design of the MLI is such that it can modify any treaty, whether it is based on the UN or OECD model;
iii. The BEPS related measures as set out in the MLI have the potential to reduce vulnerability to the exploitation of gaps and mismatches in tax rules, which cause an artificial shift in profits to low or no-tax locations, where there is little or no corresponding economic activity;
iv. Source taxation can be preserved by ensuring that profits are taxed where the economic activities generating those profits are performed and where value is created;
v. The MLI can strengthen source taxation, especially by addressing treaty shopping and abuse of the taxable presence requirements in the definition of a permanent establishment.

Despite pointing out that over the last fifty years there has been a steady drumbeat by academics urging the developing countries not to sign DTAs with developed countries, precisely because these treaties favour developed countries over developing countries, Zolt urges developing countries to sign the MLI.[137] He opines that although many specific BEPS recommendations possibly serve certain developing countries better than others, the opportunity to adopt rules to limit many types of aggressive tax

135 Oguttu (n 56 above) 223.
136 A Oguttu 'Should developing countries sign the OECD multilateral instrument to address treaty-related base erosion and profit shifting measures?' (2018) *Centre for Global Development Policy Paper 132* 4.
137 Zolt (n 129 above) 1.

planning strategies is too good to pass up. Tax authorities currently have political cover and support from international organisations in adopting a more robust international tax regime.[138]

Yet the question remains, has the time for adopting a more robust international tax regime not come and gone, with the development and finalisation of the BEPS project and the MLI? Zolt continues to state:

> [D]eveloping countries can continue to search for ways to increase source-based taxation if they determine that it is in their self-interest, whether through unilateral, bilateral or multilateral avenues.

The above statement highlights that the search for increased source-based taxation is again laid at the feet of developing countries, through 'unilateral' 'bilateral' or 'multilateral' avenues, this whilst the most profound multilateral changes to tax in history, has just been implemented. This reiterated the criticism that developing countries were not consulted to table their concerns before the OECD action agenda was drafted. Further, the concern that the system fosters inequality and is not a global reflection of addressing BEPS concerns is voiced.[139] Fung[140] describes this as a marginalisation of the voices of weaker states, a reflection of international politics, dictated by powerful states. The OECD failed to dispel the unflattering reputation it has as 'a rich man's club', when it failed to provide a platform for developing countries to participate in the initial agenda setting and decision-making process on BEPS, by merely maintaining the status quo and failing to give effect to much needed international tax reforms.[141]

In the build-up to the MLI, Oguttu contended that African countries should not be passive in relation to BEPS, whilst support for BEPS was rife and there was an international will to address BEPS issues. Reference is made by her to the ATAF conference held in Johannesburg in 2014, which was attended by various African Ministries of finance and heads of African Tax administrations. Participants from twenty-nine African countries participated alongside representatives. ATAF, in the 'conference outcome document' noted that in order to develop rules regarding global

138 Zolt (n 129 above) 37-38.
139 Oguttu (n 134 above) 20.
140 Fung (n 78 above) 88.
141 As above.

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taxation, the development of rules should be conducted in such a manner that it addresses the concerns of all countries and be inclusive. It was concluded that Africa should utilise the BEPS opportunity and attention should be given to the readiness of Africa's tax authorities to deal with BEPS.[142]

South Africa is not a member of the OECD but has observer status within the OECD and was a member of the OECD BEPS committee. Further South Africa is the only African country of the G20 and a major economic power on the African continent. Oguttu contends that South Africa plays an important role in conveying the views of developing economies in Africa, but she emphasises that the membership of South Africa to these international bodies is not representative of the interests of African countries.[143] Nevertheless, it is incomprehensible to think that the rest of Africa did not look to South Africa and consider its position when deciding how to react to the MLI and the BEPS era in general. There were numerous concerns for developing countries in considering adopting the MLI which included:[144] The interests of developing countries; concerns arising from the flexibility of the MLI; complexity; uncertainties created by the MLI; and the OECD becoming a world tax organisation. Each is shortly summarised below, serving as a reflection of the above discussion.

The interests of developing countries

This has already been highlighted above, which leaves the question open whether the MLI will be instrumental in alleviating the BEPS concerns of developing countries.

Concerns arising from the flexibility of the MLI

This related to concerns that the MLI will not be adopted uniformly, and that states can opt out of some provisions, even possibly the 'bare minimum' standards. This opting out can lead to continuation of tax-planning strategies which the MLI is intended to restrict.

142 Oguttu (n 134 above) 22.
143 As above.
144 Oguttu (n 56 above) 258-265.

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Complexity

The reservation and option mechanism of the MLI can be complicated. The OECD has attempted to alleviate this by developing a toolkit for countries that wants to sign the MLI.

Uncertainties created by the MLI

The conclusion of a DTA is a bilateral undertaking between two states, which stems from a negotiation and 'give and take' scenarios, often with an underlying rationale or purpose. The MLI can possibly impact on the terms agreed upon by two countries and alter to position to such an extent that the parties would not have originally agreed to those terms and conditions. Further, a country might elect that the MLI will not apply to a DTA or that certain provisions of the MLI will not be applicable to the DTA, which will increase uncertainties, and the uniform application of the MLI.[145] A similar situation can arise where there is an existing DTA between parties, but the one party is a signatory to the MLI and the other is not. In such circumstances the MLI will not find application.

The OECD becoming a world tax organisation

As referred to hereinabove, there are concerns that the OECD is positioning itself as some 'leader' in worldwide international taxation, to the exclusion of developing countries.

Tax remains only one of the considerations to consider in the greater scheme of economic relations with other countries. Thus, great care should be taken in considering whether to sign the MLI, in order to prevent endangering national economic interests. It has been recommended that developing countries which are not involved in the BEPS process should adopt a wait and see approach. This may enable them to observe the approaches adopted by other countries and consider the possible effect of the MLI, as well as the possible opting out of certain provisions.

The IMF has warned developing countries to be hesitant of entering into further tax treaties. This stance can also be applied to the MLI. Considering the possible

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[145] OECD 'Explanatory statement to the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting' available online at: https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf (accessed 3 August 2019) 3.

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economic implications, the interpretation issues that will arise from Action 6, the role South Africa plays as a leading African economy and the overall lack to address the concerns of developing countries, it is submitted that South Africa should have refrained, for the time being, from signing the MLI and adopted the so-called wait-and-see approach.

South Africa, like many other countries hastening to sign the MLI, effectively gave grater legitimacy to the OECD and the BEPS project.[146] As demonstrated above, from the inception of tax treaties, they have been drafted and implemented in such a fashion as to be more beneficial to developed countries as opposed to developing countries. Probably the greatest criticism that can be levelled against the BEPS project and the MLI is perhaps the failure to address the core issues relating to BEPS and source and residence-based taxation. South Africa has already signed the MLI and further has a substantive DTA network in place. The proverbial horse has bolted for South Africa in this regard. The extent to which the MLI will effectively alleviate BEPS in South Africa and other developing countries, remain to be seen.

It can only be recommended that South Africa pays close attention to its current treaty partners and which provisions of the MLI they opt out off. South Africa should consider the BEPS issue as a multifaceted difficulty ranging from tax treaties to economic realities. South Africa participated in the BEPS project and is a leading economy on the African continent. As referred to above, it is suggested that in the current BEPS environment there is room to address the fundamental BEPS issues, and now is the time to do so.

South Africa participated in BEPS, is a member of the G20 and was one the countries to immediately sign the MLI, again, if by doing so, South Africa demonstrated its willingness to adapt to international standards, then this must be leveraged from. In considering its tax position deliberation must be given to the treaties in place and whether, in light of all the surrounding circumstances above, the renegotiating of substantial tax issues like source-country taxation should not take place now. South Africa can take a page from Malawi’s book who terminated its colonial 1969 treaty with

[146] Fung (n 78 above) 88.

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the UK, Northern Ireland and the Netherlands. In terms of this treaty no provision was made for withholding taxes in Malawi, a situation which was unacceptable to Malawi.

The renegotiated treaty with the Netherlands now contains an anti-treaty abuse provision and higher withholding tax rates, tax on interests, dividends and royalties.[147] These categories of taxes will provide an appropriate point of departure for South Africa upon considering our own treaties. There seems to be some change to the approach of treaty abuse by developed countries. The Netherlands is one country that appears to have changed its approach. It was not only Malawi, but the Netherlands has renegotiated tax treaties with twenty-three other developing countries, which include: Ethiopia; Ghana; Kenya; and Zambia, each containing anti-abuse provisions and higher withholding tax rates.

South Africa is a major economy on the African continent and it should utilise its position by amicably seeking to address substantial issues pertaining to BEPS, whilst the current determination and opportunity to do so exists, South Africa should not sit idly whilst other developing countries attempt to address the issue. For an international tax system to be fair and truly address BEPS, it cannot lean in favour of the interests of one category of countries. Where it was discoursed that South Africa should have refrained, for the time being, from signing the MLI, it is now recommended that South Africa earnestly address the issue of taxing rights in DTAs. Perhaps this will spark renewed determination amongst other developing countries to do the same.

5.2 Concluding remarks

The research questions identified, have each been answered by the research as follows:

a) The effectiveness of Action 6 in addressing BEPS remain to be seen. Most of the DTAs that have been signed, which are based on newer versions of the MTC, may not require modification by the MLI.[148] The 'limitation of benefits' provisions have been described as mind boggling and which will result in a predominant adoption of the PPT.[149] Furthermore, certain tax avoidance measures aimed at circumventing domestic tax rules will not be addressed by the treaty provisions,

[147] Oguttu (n 19 above) 335.
[148] Oguttu (n 56 above) 233.
[149] De Broe *at al* (n 107 above) 146.

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whilst reliance could possibly be placed on the overriding treaty provisions to circumvent domestic legislation. The change to the preamble of treaties to include a provision stating that tax avoidance is now a treaty objective is largely cosmetic.[150] The fact that tax avoidance is now a treaty objective, cannot be construed as overriding the other legitimate purposes of the treaty and cannot override the other treaty provisions.[151]

b) Upon considering the historical development of the OECD and the manner in which the OECD developed its policies on international tax issues, it is apparent that historical events prompted the need to address issues of international taxation. WWI, WWII and the global economic collapse of 2008 stand as beacons of the very development of the OECD and its latest undertaking to address the BEPS issue. The global economic collapse of 2008 greatly affected developed economies and in the aftermath of the carnage, as it was again the developed countries that set the stage for addressing the BEPS issue. This reinvigorated the perception that the OECD was more concerned with the interests of developed countries, as opposed to those of developing countries. The OECD remains a representative of its member countries, predominantly developed countries, and their interests, at least for the time being, will remain the predominant consideration of the OECD.

c) For South Africa and other developing countries, there is a plethora of considerations when considering tax treaties and tax abuse. In Africa (and other developing countries) the corporate tax system is of pivotal importance as a source of revenue and must be maintained.[152] This revenue plays an important role in the development and infrastructure creation for developing countries. This must however be weighed against creating an environment that is conducive to foreign trade and investment which in turn directly impacts development and economic growth. Tax treaties takes approximately two years to negotiate. The 'life-expectancy' of a treaty is between ten and thirty years before same needs to be re-negotiated.[153] The negotiating of tax treaties is a complex matter, requiring technical skill and a solid knowledge of the operation of tax treaties and international taxation.[154] The MLI does provide a cost effective and relatively simple

150 As above.
151 As above.
152 Oguttu (n 134 above) 11.
153 Thuronyi (n 23 above) 7.
154 Oguttu (n 134 above) 11.

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way for developing countries to address tax treaty abuse, in a manner that would not have been possible if the respective treaties would have to have been renegotiated individually. The OECD's failure to address the core issue of unfair source taxation is indeed an opportunity missed, when the time and circumstances were conducive to address this issue. However, considering the current landscape of international taxation, it would in the best interests of developing countries to sign the MLI, albeit that it can be considered 'second prize'.

d) Notwithstanding that the potential argument that South Africa should have refrained, for the time being, from signing the MLI, the chances of this materialising would have been slim. South Africa's membership of the G20, along with its observer status within the OECD and the need to create the perception of indeed being open to the international tax norm, diminished the possibility that South Africa would have adopted this norm by temporarily refraining from signing the MLI. Nevertheless, South Africa could have meaningfully participated in the BEPS project whilst refraining from hastening to sign the MLI. This could have resulted in a position whereby South Africa could have demonstrated its intention of effectively addressing core taxation issues, and possibly could have addressed those issues more effectively with parties to its DTAs.

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Annexure G

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Declaration of originality

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Declaration

1. I understand what plagiarism is and am aware of the University's policy in this regard.

2. I declare that this mini-dissertation is my own original work. Where other people's work has been used (either from a printed source, Internet or any other source), this has been properly acknowledged and referenced in accordance with departmental requirements.

3. I have not used work previously produced by another student or any other person to hand in as my own.

4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.

Signature of student: ....

Signature of supervisor: ....

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