THE EFFECTIVENESS OF THE SOUTH AFRICAN DOUBLE TAXATION RELIEF PROVISIONS FOR SOUTH AFRICAN COMPANIES INVESTING IN OTHER AFRICAN STATES

by

ELIZABETH LUCY DE SOUZA DRUMMOND

Student number 10654195

Submitted in partial fulfilment of the requirements for the degree

Magister Commercii in Taxation

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

STUDY LEADER: Mr Puleng Owen Manyaka

Date of submission:
2012-10-12

ACKNOWLEDGEMENTS

I would like to express my gratitude to my study leader, Mr Puleng Manyaka, and to Mrs Hanneke du Preez for their encouragement and patience, especially during the tough times.

I convey my appreciation to the local and international tax experts who generously gave of their time in assisting me with my research.

Finally, I thank my family, friends, and colleagues for their support and belief that I would reach the top of this Everest.

ABSTRACT

THE EFFECTIVENESS OF THE SOUTH AFRICAN DOUBLE TAXATION RELIEF PROVISIONS FOR SOUTH AFRICAN COMPANIES INVESTING IN OTHER AFRICAN STATES

by

ELIZABETH LUCY DE SOUZA DRUMMOND

STUDY LEADER: MR PULENG OWEN MANYAKA
DEPARTMENT: TAXATION
DEGREE: MAGISTER COMMERCII

South Africa has expressed its desire to be the gateway for investment into Africa. With its residence-based tax system which taxes the worldwide income of its tax residents, South African companies will be open to double taxation where the investee country claims jurisdiction to tax income generated from within its borders. In addition, other provisions in the South African tax legislation increase the possibility of double taxation by including the income of foreign subsidiaries. Two such examples are the definition of a tax resident, which includes foreign subsidiaries that are effectively managed by their holding companies in South Africa, and the anti-avoidance measures, such as the controlled foreign company provisions, which impute the income of a foreign subsidiary to the South African investment company.

Many South African companies have chosen to route their investments in African countries through foreign subsidiaries. Besides having a more investor-friendly tax regime, these countries offer more favourable relief from double taxation, both unilaterally and by means of their network of tax treaties. South Africa has identified some of its shortcomings. It has introduced concessionary tax provisions for locally based headquarter companies that invest abroad. It recognises the high cost of doing business in Africa due to the fact that many African countries impose withholding taxes on several types of income even though they may not be from a local source. Therefore, South Africa is granting tax rebates for foreign withholding taxes paid on service fees charged to foreign entities despite the income being derived from a South African source. Both these measures reduce double taxation but, are they sufficient to encourage direct investment from South Africa into other African countries?

This study seeks to evaluate the effectiveness of the South African double taxation relief provisions by using a case study of a South African company that has investments in several African countries. It compares the application of the double taxation relief provisions of South Africa, another African country and a non-African country to the case study. It analyses the outcomes and assesses the effectiveness of South Africa's current legislation for unilateral tax relief and its tax treaties in minimising double taxation. Finally, it makes some recommendations on possible improvements to the legislation in order to achieve the stated goal of being the financial hub for investment into Africa.

Key words:

International taxation

Double taxation

Double taxation relief

Foreign source income

Foreign tax credits

Tax exemptions

OPSOMMING

Deur

ELIZABETH LUCY DE SOUZA DRUMMOND

STUDIE LEIER: MNR PULENG OWEN MANYAKA
DEPARTEMENT: BELASTING
GRAAD: MAGISTER COMMERCII

Suid Afrika het aangedui dat dit die poort vir belegging na Afrika wil wees. Die heffing van belasting op die wêreldwye inkomste van belastingpligtige inwoners stel Suid-Afrikaanse maatskappye egter bloot aan dubbelbelasting indien die land waarin beleggings gemaak word ook aanspraak maak op die reg om inkomste wat in daardie land verdien is, te belas. Sekere bepalings in die Suid-Afrikaanse belastingwetgewing stel belastingbetalers verder bloot aan dubbelbelasting indien die inkomste van buitelandse filiale ook by die inkomste van inwoners ingesluit moet word. Twee sulke voorbeelde sluit die definisie van belastingpligtige inwoner ingevolge waarvan buitelandse filiale wat effektiewelik deur hulle houermaatskappy in Suid-Afrika bestuur word en sekere teenvermydingsmaatstawwe, soos byvoorbeeld die beheerde buitelandse maatskappy bepalings ingevolge waarvan die inkomste van ŉ buitelandse filiaal aan ŉ Suid-Afrikaanse beleggingsmaatskappy toegeskryf word, in.

Daar is heelwat Suid-Afrikaanse maatskappye wat verkies om hulle beleggings in Afrika deur middel van filiale wat in ander lande geregistreer is, te hou. Hierdie gekose lande het nie net gunstige belasting instellings bewinde nie maar bied ook meer voordelige verligting van dubbelbelasting, beide eensydig en deur middel van hulle netwerk van belastingooreenkomste, aan. Suid-Afrika het sy tekortkominge geidentifiseer. Voordelige belastingbepalings is geskep vir plaaslike hoofkantoor maatskappye wat beleggings in die buiteland hou. Erkenning is gegee aan die hoë koste om besigheid in Afrika te doen as gevolg van die feit dat menige Afrika-lande belasting op verskeie tipe inkomste weerhou

selfs as die oorsprong van die inkomste nie vanuit daardie lande kom nie. Suid-Afrika is gewillig om belastingkortings vir die buitelandse belasting so weerhou toe te staan ten spyte daarvan dat die oorsprong van die inkomste in Suid-Afrika is. Beide die maatstawwe is gemik op tot die vermindering van dubbelbelasting, maar is dit voldoende om direkte beleggings vanaf Suid-Afrika in ander Afrika-lande aan te moedig?

Die doelwit van hierdie studie is om te bepaal hoe effektief die Suid-Afrikaanse bepalings wat gemik is om dubbelbelasting te verhoed deur middel van ‘n gevallestudie van ʼn Suid-Afrikaanse maatskappy wat meervoudige beleggings in verskeie Afrika-lande het. Die studie vergelyk die toepassing van die vermindering van dubbelbelastingbepalings van Suid-Afrika, ʼn ander Afrika-land en ʼn nie-Afrika-land. Die resultate word geanaliseer en die effektiwiteit van die huidige wetgewing vir eensydige verligting van dubbelbelasting en die huidige belastingooreenkomste om dubbelbelasting te verminder, word beraam. Ten slotte, die studie beoog ook om aanbevelings wat dalk die wetgewing kan verbeter ten einde die gewensde doelwit om Suid Afrika die finansiële poort vir beleggings in Afrika te bereik, te maak.

Sleutelwoorde:
Internasionale belasting
Dubbelbelasting
Verligting van dubbelbelasting
Inkomste van buitelandse oorsprong
Korting vir buitelandse belasting
Belastingvrystellings

TABLE OF CONTENTS

APPENDICES

LIST OF TABLES

THE EFFECTIVENESS OF THE SOUTH AFRICAN DOUBLE TAXATION RELIEF PROVISIONS FOR SOUTH AFRICAN COMPANIES INVESTING IN OTHER AFRICAN STATES

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

No one likes to pay taxes. More particularly, no one wants to pay tax more than once on the same income.

Since 2001, South Africa has moved from a source-based taxation system to a system based on residence. As a consequence, South African residents are now taxed on their worldwide income, which has exposed them to double taxation. Honiball and Killoran (2011a:43) note that countries can differ in their interpretation of the following key factors which can give rise to double taxation:

- residence of the taxpayer
- source of the income
- attribution of income to a particular state
- tax terms and provisions

A country can alleviate the double tax burden on its residents through its domestic tax laws or by entering into tax treaties with other countries. The meaning of certain terminologies, such as the aforementioned terms, can also be clarified in the tax treaties between the two contracting states. (Olivier & Honiball, 2010:4).

South Africa offers unilateral tax relief to taxpayers in terms of section 6*quat* of the Income Tax Act No. 58 of 1962 (hereinafter referred to as the Act). The provision allows a rebate on the foreign taxes paid against the current income tax liability or a deduction of the foreign taxes paid against taxable income, subject to certain restrictions and limitations.

In the Taxation Laws Amendment Act No. 24 of 2011, section 6*quin* was enacted to grant a rebate to taxpayers who have been taxed by another country on services rendered that are from a source within South Africa and are, therefore, also subject to tax in South Africa.

The provisions of section 108 of the Act allow South Africa to enter into agreements with other countries with the specific purpose of preventing or giving relief from double taxation. To date, South Africa has entered into tax treaties with 70 countries to achieve this objective (South African Revenue Service, undated). However, these measures have not been sufficient to encourage South African resident companies to invest directly into African countries rather than setting up “intermediary holding companies” in other tax jurisdictions to facilitate investment into Africa. An intermediary holding company (IHC) is a company that is interposed between the ultimate investment or holding company, located in one country, and the investee or subsidiary company, located in another country (Olivier & Honiball, 2010:576). The IHC usually resides in a third country which provides tax advantages over direct investment into the subsidiary by the holding company.

In order to address this problem, the Taxation Laws Amendment Act No. 24 of 2011 has introduced more concessions to headquarter companies located in the Republic in pursuit of its goal to be the financial “Gateway to Africa” (National Treasury, Republic of South Africa, 2011:3). A headquarter company (HQC) is a company within a multinational group of companies that supervises and co-ordinates the business activities of the group’s subsidiaries located in a particular region (Legwaila, 2010:34, Olivier & Honiball, 2010:575).

Literature published on investing in Africa has emphasised the need to assess the tax costs of doing business in the target country when deciding on the location of the investing company (Edward Nathan Sonnenbergs, 2010; Ernst & Young, 2005; Slenderbroek, 2011:22; Spamer & Buttrick, 2012:5-6). In addition, comments on the new provisions for headquarter companies in the Act have not been favourable, particularly when comparing them with double taxation relief provisions in Mauritius (Goba & Burger, 2010:6-7, Honiball & Killoran, 2011a:42-44; Honiball & Killoran, 2011b:29-32).

The question therefore arises: Are the South African double taxation relief provisions effective in providing relief for South African companies investing into other African countries?

1.2 PROBLEM STATEMENT

In some African countries, certain charges are subject to withholding taxes, such as management and technical fees, interest, dividends and royalties.

The provisions of section 6*quat* and section 6*quin* of the Act limit a rebate on foreign taxes paid to the equivalent South African income tax payable on the "foreign taxable income". The withholding taxes, however, have been levied on the gross amount of the revenue derived from the foreign entity. Furthermore, the methods used to determine foreign taxable income as a basis for quantifying the foreign tax rebate is not definitive under the aforementioned sections of the Act. Consequently, calculations of foreign taxable income become complex and onerous, especially with respect to the allocation of costs to foreign income. For example, a South African company, that has subsidiaries in African countries, receives management fees for services rendered to those subsidiaries. When such fees are merely charges for the recovery of costs, with no mark-up added, there will be no foreign income earned by the South African company and therefore no foreign taxable income. Consequently, no foreign tax rebate can be claimed under sections 6*quat* or 6*quin* of the Act.

Section 6*quin* stipulates that a taxpayer must submit a claim to the South African Revenue Service (SARS) for a foreign tax rebate within 60 days of having had the foreign tax withheld. Failure to do so will result in the forfeiture of the rebate. In addition, the amount of the foreign tax eligible for rebate is confined to the year of assessment in which the income accrues to the taxpayer. Any foreign tax paid that exceeds the amount allowable in terms of the provisions of this section of the Act cannot be carried forward and offset against future foreign taxable income as is the case in section 6*quat*. These time restrictions in section *6quin* could render the provision for tax relief ineffective.

Although the foreign taxes incurred may be reduced if there is a tax treaty between South Africa and the other African country, these rates may not be as favourable as those agreed to in treaties with other tax jurisdictions.

1.3 PURPOSE STATEMENT

The purpose of this study is to evaluate the effectiveness of using the tax relief provisions in the Act to reduce double taxation incurred by South African resident companies when they invest into other African states.

1.4 RESEARCH OBJECTIVES

The study will be guided by the following research objectives:

- to review the provisions of the tax legislation of South Africa, Mauritius and the Netherlands which provide relief from double taxation on foreign income earned by residents of these countries;
- to compare the tax relief granted by South Africa to minimise double taxation against that granted by Mauritius and the Netherlands;
- to assess the effectiveness of the South African double taxation relief provisions compared with those of Mauritius and the Netherlands, based on a case study.

1.5 IMPORTANCE AND BENEFITS OF THE STUDY

South Africa has stated its goal of becoming a regional financial centre for Africa (National Treasury, Republic of South Africa, 2010:3). According to Goba and Burger (2010:7), Mauritius is currently the first-choice country of foreign multinationals for setting up a holding company to invest into Africa. In order for South Africa to compete with, or overtake Mauritius, it must provide relief from double taxation to enable South African resident companies to invest directly into Africa or that attracts multinationals to locate their headquarter companies in South Africa. The benefit of this study will be to assess whether the current tax regime will achieve this goal or whether it needs to make further reforms.

1.6 DELIMITATIONS

This study is confined to the effects of double taxation relief on companies. It focuses on companies that are tax residents of South Africa as defined in section 1 of the Act. It includes companies that do not have a physical presence in a foreign country, either as a branch or a separate company incorporated in that country but which do business with entities in that foreign country and derive income from them. The study does not address the double taxation relief provisions relating to individuals, partnerships and trusts.

The research examines the legislative framework provided to reduce double taxation in South Africa and makes a detailed comparison of similar provisions in the tax legislation of another African country, namely Mauritius, and a non-African country, being the Netherlands.

The study does not cover cross-border transactions which relate to:

- thin capitalisation, which is the funding of an investment into a company by the use of a high level of debt rather than equity in order to maximise the deduction of interest;
- transfer pricing, which is the adjustment of prices between group companies trading across international borders in order to take advantage of different tax rates in different countries; and
- controlled foreign company legislation where the pro rata net income of a company in which a domestic company has invested is imputed to that domestic company and taxed by the local authorities.

These issues are regarded as anti-avoidance measures in the tax legislation and are therefore outside the scope of the study.

Double taxation is examined in the context of juridical double taxation. This is defined as the taxation of the same income by more than one tax jurisdiction on the same taxpayer. By contrast, economic double taxation occurs when the same income is taxed by more than one tax jurisdiction on different taxpayers (Olivier & Honiball, 2010: 314-315).

The study does not deal with non-tax-related matters that may influence the decision of an investor to establish a company in South Africa. These factors include exchange controls and political conditions prevailing in the country.

1.7 ASSUMPTIONS

It is assumed that a taxpayer will benefit equally from the provisions in the tax legislation for lessening double taxation irrespective of the African country in which it invests. However, if there is a tax treaty with the African investee country, the benefits of reduced double taxation may differ.

1.8 DEFINITION OF KEY TERMS

Contracting state: a country that is one of the parties to a double taxation agreement (Olivier & Honiball, 2010:572).

Controlled foreign company: a foreign company that is controlled by a local company by virtue of the extent of the other company's shareholding or voting rights in the foreign company.

Double taxation agreement (also known as a tax treaty or treaty): an international agreement between two countries aimed at avoiding double taxation on the same income subject to tax in both countries. These terms will be used interchangeably. (Olivier & Honiball, 2010:573; South African Revenue Service, 2009:2).

Foreign taxable income: income derived from a foreign source, reduced by expenses directly and indirectly attributable to that foreign-source income, that is taxable (South African Revenue Service, 2009:22-23).

Foreign tax credit or rebate: a reduction in a taxpayer's local taxes equal to some or all of the taxes paid on that income in the other country, granted in a case where a taxpayer is liable for tax on the same income by two different countries (Olivier & Honiball, 2010:575).

Headquarter company: a company which is part of a multinational group of companies that supervises and co-ordinates the business activities of its subsidiaries located in a particular region (Legwaila, 2010:34: Olivier & Honiball, 2010:575).

Holding company: a company that has control over one or more companies in a group of companies by virtue of its significant shareholding and/or the exercise of voting rights.

Home country: the country from which a tax resident makes investments abroad (Olivier & Honiball, 2010:575).

Host country: the foreign country into which a local investor makes overseas investments (Olivier & Honiball, 2010:575).

Intermediary holding company: a subsidiary company which is interposed between a holding company and its foreign operating subsidiaries and is used to hold the shares in the foreign subsidiaries (None of the three company structures, namely, the holding company, the IHC and the foreign subsidiaries, are located in the same country.) (Olivier & Honiball, 2010:576).

Permanent establishment: a fixed place of business, through which an enterprise wholly or partially conducts its activities (OECD, 2010:Article 5).

Resident: a resident of a particular country for income tax purposes as defined by the legislation of that country (OECD, 2010:Article 4).

Source: the originating cause of deriving income, whether by means of trade in goods or services or by investment, and the location of that originating cause (South African Revenue Service, 2009:11).

Withholding tax: a tax levied at a flat rate by a country on a specific type of income such as dividends, interest, fees, or royalties, payable to a foreign recipient, which is deducted before the payment is remitted to the recipient by the debtor (The debtor pays the tax over to the government that is withholding the tax.) (Olivier & Honiball, 2010:581).

The following abbreviations listed in Table 1 will be used in the body of the text.

Table 1: Abbreviations used in this document

Abbreviation	Meaning
CEN	Capital export neutrality
CFC	Controlled foreign company
CIN	Capital import neutrality
DTA	Double taxation agreement
EM	Exemption method
FTC	Foreign tax credit
GBL1	Category 1 Global Business Licence in terms of Mauritian law
HQC	Headquarter company
IHC	Intermediary holding company
IN No. 18	SARS Interpretation Note No. 18 (Issue 2) of 31 March 2009
MRA	Mauritius Revenue Authority
MRR	Marginal reimbursement rate
MTR	Marginal tax rate
OECD	Organisation of Economic Development and Co-operation
OECD Model	OECD Model Tax Convention
SARS	South African Revenue Service
UN Model	United Nations Model Tax Convention

1.9 RESEARCH DESIGN AND METHOD

This study uses a qualitative approach to the research. It critically reviews international literature on the theories on which tax policies are based and discusses the local literature relating to the impact of South African tax legislation on the use of South Africa as a conduit for investment into Africa. The literature was sourced from a local textbook on international tax, articles in journals and published reports accessed from the library and the internet as well as information from government websites relevant to the study.

South Africa's double taxation relief measures are compared with those of Mauritius and the Netherlands. Mauritius has been selected as another African country for this study. This country's low corporate tax rate and generous foreign tax relief mechanisms have made it a favourite destination for use as a springboard for investment into other African countries. The Netherlands has been chosen as a non-African country for comparison with South Africa. It is an attractive country in which to set up an IHC or HQC on account of its large network of tax treaties throughout the world (Legwaila, 2010:11). Information has been sourced from a doctoral thesis that has also used these two countries for comparative purposes (Legwaila, 2010). The websites of the Mauritian and Netherlands tax authorities have been accessed for their legislation. Telephonic and written communication has been held with tax experts in the two countries as additional resources.

A case study is made of the actual experience of a South African company utilising the double taxation relief provisions in order to reduce double taxation arising from its investment into Africa. Face-to-face interviews have been conducted with staff in the company to obtain information on the circumstances relating to the case and the actions taken by the company to obtain relief from double taxation. Access was also given to tax assessments and correspondence with SARS on the particular matter.

Tax experts in South Africa have been canvassed to elicit their assessments of the effectiveness of the double taxation relief provisions and the areas where there may be a need for change in the legislation.

The following individuals were interviewed, either face to face or telephonically:

Name	**Designation**
Charles Makola	Director of International tax, National Treasury
Des Kruger	Director, Business Tax Advisory, Ernst & Young

Name	Designation
Michael Honiball	Partner, Webber Wentzel
Martie Foster	Corporate Tax Consultant, Corporate Law Alliance
Bradley Pearson	Associate Director, Tax, Deloitte
Rosalie Reinders	Tax Adviser, Bird & Bird LLP, Netherlands
Roopesh Dabeesingh	Tax Manager, Multinational Accounting Firm

Mr Makola was interviewed in order to understand National Treasury's approach to reducing double taxation, particularly regarding the concessions granted in terms of section 6*quin* of the Act and the HQC provisions.

The experts selected were a mix of advisors from large accounting and legal firms. Des Kruger and Michael Honiball are recognised South African tax experts, both nationally and internationally. In addition, Mr Honiball is the co-author of the only South African textbook on international tax. Ms Foster is an independent tax consultant who has worked in renowned accounting and legal firms. She serves as a member of the national tax committee at the South African Institute of Chartered Accountants. Mr Pearson represents the tax department of a multinational accounting firm.

Ms Reinders is a tax advisor at a reputable law firm in the Netherlands and Mr Dabeesingh is a tax manager at the Mauritian branch of a multinational accounting firm. They were consulted on the mechanisms used in their respective countries for reducing double taxation. They also advised on the double tax relief measures that could be applied in the context of the case study.

The interviews were conducted in a semi-structured manner. The participants were given a copy of the Introduction and Consent letter and requested to sign it if they agreed to an interview and to be cited in the study (See Appendix A). The procedure followed for the interviews was to provide a schedule of questions to the interviewees in advance (Appendix B). The questions were framed very broadly so that the participants were able to explore the issues as widely as possible during the discussions.

All interviews were recorded. They were then transcribed and sent to the interviewees for confirmation that the information was accurate.

1.10 OVERVIEW OF CHAPTERS

The research study is made up of seven chapters which comprise the following:

1.10.1 Chapter 1: Introduction and problem statement

This chapter gives the background to the study and defines the problem and purpose statements. It also identifies the research objectives, the importance and benefits of the research and the parameters within which the research was conducted.

1.10.2 Chapter 2: The tax system, tax policy and double taxation

As a background to the study, this chapter discusses the structure of a tax system, the principles on which it is based and the importance of the concepts of source and residence. It also reviews the measures used to alleviate double taxation.

1.10.3 Chapter 3: Literature review

The study encompasses a review of international studies on the theories behind tax policy and their relationship to double taxation relief measures. It examines local studies on the association between the South African tax legislation and the use of South Africa as a channel for investment into other African countries.

1.10.4 Chapter 4: Review of double taxation relief provisions in South Africa, Mauritius and the Netherlands

This chapter outlines and compares the provisions for relief from double taxation in the legislation of South Africa, Mauritius and the Netherlands. It evaluates the effectiveness of the respective tax treaty networks.

1.10.5 Chapter 5: Case study

The research presents a case study of a South African company that has investments in other African countries. It compares the remedies available to the South African company to mitigate double taxation with those available in Mauritius and the Netherlands under the same circumstances.

1.10.6 Chapter 6: Analysis of the effectiveness of the double taxation relief provisions in South Africa

Based on the literature review, the case study and interviews conducted with experts, an analysis is made of the effectiveness of South Africa's double taxation relief provisions with particular emphasis on their efficacy when investing into other African countries.

1.10.7 Chapter 7: Conclusion

Based on the research, the study draws conclusions on the value of South Africa's double taxation relief provisions. It makes recommendations on changes required in the legislation or the need for further studies to be conducted on how to improve South Africa's effectiveness in reducing or eliminating double taxation if it intends to be the gateway for investment into Africa.

CHAPTER 2

THE TAX SYSTEM, TAX POLICY AND DOUBLE TAXATION

2.1 INTRODUCTION

The structure of a country's tax system is determined by what and who is to be taxed and the principles upon which tax policy is based. There are two types of tax systems which will answer the "what" and "who" questions, namely source-based and residence-based tax systems.

2.2 SOURCE-BASED TAX SYSTEM

The source-based system implies that there is a link between the income to be taxed and the country which is imposing the tax (Olivier & Honiball, 2010:50-51). A country that adopts this system only taxes income from a source within its geographical borders. Lokken (2011:26) states that the rationale for taxing such income is premised on two principles, namely, the benefit principle and the ability to pay principle.

The benefit principle ensures that the taxing authority recovers the costs of the services it provides to the taxpayer. As the second principle suggests, the total tax burden is shared amongst the taxpayers according to their ability to pay. This is evident where a country has a progressive tax system. It means that the higher a taxpayer's total income per annum, the higher the rate of tax charged per Rand of income earned (Lokken, 2011:26).

Rigby (1991:305), on the other hand, criticises the source-based tax system because it does not distinguish between residents and non-residents. He maintains that non-residents should not be taxed the same way as residents because they use far fewer resources than residents in the source country. He argues that the only reasons that countries tax non-residents are that, firstly, they believe that they are entitled to tax the value added by the foreign factors of production derived from the country and, secondly, they have the first opportunity to tax the non-resident. This view does not take cognisance of the fact that, if a non-resident has a business enterprise that is operating and utilising the same amount of resources as a local enterprise, it should incur the same amount of tax as its domestic counterpart. With regard to passive income, the case for reducing taxes imposed on non-residents can be supported. This often happens in reality where non-residents are subject to withholding taxes on such income, which are lower than normal taxes on income.

2.3 RESIDENCE-BASED TAX SYSTEM

The residence-based system identifies a connection between the taxpayer and the taxing country (Olivier & Honiball, 2010:50). In these circumstances, the source of the income is ignored and a resident is taxed on his worldwide income. Rigby (1991:305) states that this method of taxation ensures that there is neutrality in taxing residents with respect to where they derive their income. They are taxed the same way, whether they invest domestically or abroad.

2.4 TAX POLICY

The decision on whether to use a source-based or residence-based tax system is influenced by the tax policy objectives of a country. The two most common approaches are the capital export neutrality principle (CEN) and the capital import neutrality principle (CIN).

2.4.1 Capital export neutrality

Capital export neutrality occurs when a country is neutral about the location of a taxpayer's investments. Foreign or domestic investments with the same pre-tax return are levied with the same amount of tax by the authorities. (Rigby, 1991:305). A country using a residence basis of taxation would be capital export neutral if it granted FTCs because all the income of a resident, irrespective of its source, would be taxed at the same rate.

2.4.2 Capital import neutrality

This occurs when all investors in a country are taxed at the same rate (Rigby, 1991:307). CIN seeks to treat all taxpayers equally and fairly and promote the efficient use of global resources (Larkins, 2001:249). A country which uses a source-based system of taxation would be capital import neutral if it exempted foreign sourced income since it would be taxing both local and foreign investors at the same rate on domestically sourced income.

2.5 SOURCE AND RESIDENCE RULES

The elements of source and residence are not mutually exclusive to the source-based and residence-based tax systems respectively (Olivier & Honiball, 2010:51). For instance, a country using a source-based system will have to identify non-residents so as to ensure that they are taxed on income derived from a source within that country. Some jurisdictions tax certain types of income, such as royalty payments, which they “deem” to be from a source within the country although, in reality, the income does not originate from a source within its borders (Olivier & Honiball, 2010:57). A country using a residence-based tax system could include rules to exempt certain types of foreign-sourced income from taxation.

The meaning of source and residence in tax legislation is therefore significant in establishing whether income will be taxed in a particular jurisdiction. There is no international definition of these terms and, where there is an overlap, it can give rise to double taxation. In addition, the source and residence rules play a role in determining whether a taxpayer is eligible for double taxation relief or not (South African Revenue Service, 2009:10).

2.6 DOUBLE TAXATION

Irrespective of the type of tax system that a country adopts, a taxpayer, whose income is earned both domestically and abroad, may be subject to tax on the same income more than once. This would occur if the home country and the host country both claim taxing rights to the same income.

Rigby (1991:303) identifies two ways in which a country can reduce or eliminate double taxation:

- It can provide unilateral tax relief by enacting provisions in its own legislation; or
- it can enter into double taxation agreements with other countries.

2.6.1 Unilateral tax relief

There are three methods of tax relief that can be provided in a tax system (South African Revenue Service, 2009:3):

- the exemption method (EM);
- the credit method (FTC); and
- the deduction method.

2.6.1.1 *The exemption method*

The exemption method exempts foreign source income from being taxed in the home country of the investor. The result is that only domestic income is subject to tax. It is usually used in source-based tax systems. However, a residence-based system may also use it for specific types of income. (Larkins, 2001:235).

2.6.1.2 *The credit method*

The credit method offsets foreign taxes paid against the domestic tax liability. It is normally used under a residence-based tax system. Most countries tend to cap the FTC to the equivalent domestic tax payable on the foreign income. This is done to preserve the revenue base of the home country (Larkins, 2001:242).

There are some variations of the FTC method which, to a greater or lesser degree, restrict the foreign tax credit granted in a tax year (Larkins, 2001:239–244).

- *The direct credit method.* This occurs where a business has a flow-through structure such that the profits from its activities abroad are attributed to the local enterprise. Examples of such a structure would be a branch or partnership. The tax consequences are that the home and host country both tax the same income. The home country then grants an FTC on the foreign taxes paid by the branch or partnership.
- *The indirect credit method.* This applies where the local taxing authority recognises that income received from abroad has already been subject to tax. For example, if a holding company receives dividends from its foreign subsidiary, the income from which the dividends were distributed has already been taxed. Consequently, the local tax authorities allow an FTC equal to the foreign tax indirectly suffered on the dividends.
- *In lieu of credit method.* A local tax authority will allow an FTC on withholding taxes levied on foreign income received by a resident, such as dividends, interest and royalties, as a substitute for foreign income tax.
- *The pooling method.* All foreign income is pooled to determine the amount of FTC to be granted.
- *The "basket" method.* Different categories of income are grouped and the FTC limitations are applied to each basket of foreign income.

Where the foreign taxes paid exceed the FTC granted in a tax year, some countries allow the "excess credits" to be carried forward to future tax years to be treated as FTCs in the succeeding tax years. There is usually a limit on the number of years that the excess credits can be carried forward. Some jurisdictions, such as the United States, also allow for FTCs to be carried back a number of years. (Larkins, 2001:261).

2.6.1.3 *The deduction method*

The deduction method is the least favourable in terms of reducing double taxation. The foreign taxes paid are treated by the home country as a cost and are deducted from taxable income. Thus the taxpayer only obtains relief equal to the domestic tax rate (Larkins, 2001:244).

A country will use one or a combination of some or all of these measures to reduce double taxation. The application of these methods will be influenced by the tax policy adopted by the specific country. This has been the conclusion of a number of international studies. (Larkins, 2001:235; Rigby, 1991:307).

2.6.2 Double taxation agreements

A double taxation agreement (DTA), or tax treaty, is an agreement entered into between two countries with the main objective of reducing or eliminating double taxation incurred by residents of the contracting states as a result of cross-border trade.

Tax treaties resolve the following jurisdictional issues in relation to the taxation of income:

- They determine the residence of the taxpayer.
- They determine the nature of the income to be taxed.
- They determine which taxes qualify for relief from double taxation.
- They give entitlement to one or both of the contracting states to tax a particular type of income.
- Usually, they give preference to the source state to tax a specific type of income.
- They place the responsibility on the residence state to grant tax relief to the taxpayer where there is double taxation.

DTAs enhance the options for relief from double taxation. They provide a number of benefits to a taxpayer of a contracting state. The taxpayer has certainty about the jurisdiction in which he will be taxed. Often, withholding taxes imposed on certain types of income are reduced below the normal domestic rates when the tax is to be levied on a resident of one of the contracting states. A DTA is a lawfully binding contract. Therefore, there is legal recourse for the tax resident, and support by his government, if the other contracting country is in breach of the agreement.

2.7 CONCLUSION

The policy objectives of a country will influence the structure of its tax system. The simplest tax system confines itself to taxing income derived from within that country's borders, thus utilising the source-based system. If the country has the resources to widen the tax net, it would choose a residence-based system. Whichever system is used, the taxing authority needs to define the source of income and the residence of a taxpayer in order to determine what and who is to be taxed.

The use of an EM or FTC method to reduce or eliminate double taxation suffered by its taxpayers will be influenced by whether the country applies a CEN or CIN principle towards international taxation. Further tax relief is available to the taxpayer if the country enters into DTAs with other jurisdictions. It also designates where the income will be taxed.

CHAPTER 3

LITERATURE REVIEW

3.1 INTRODUCTION

Research into relief from double taxation has concentrated on examining the theoretical concepts associated with tax systems, tax policies and double taxation relief provisions (Larkins, 2010; Shaviro, 2010). Some authors have criticised the principles upon which tax policies are based (Shaviro, 2010). Others have questioned the effectiveness of tax treaties in eliminating double taxation in the new global trading environment (Rigby, 1991).

In the South African context, only one known author has made a comprehensive analysis of the double taxation relief measures afforded South African tax residents (Hattingh, 2011). Much of the literature has focused on the tax implications of using this country as a channel for investment into other African countries (Goba & Burger, 2010; Honiball & Killoran, 2011 [a], [b] & [c]). Other writers have warned of the high tax costs of doing business in Africa (Edward Nathan Sonnenbergs, 2010; Slenderbroek, 2011). However, no specific research has been done to evaluate whether the double taxation relief provisions in the South African legislation are effective in reducing or eliminating double taxation for South African resident companies, particularly for companies doing business in African countries. Some critics argue that the current South African double taxation relief provisions may be hindering the government's objective of enabling South Africa to be used as the gateway for investment into Africa (Hattingh, 2011:597; Honiball & Killoran, 2011c:32).

3.2 INTERNATIONAL STUDIES ON DOUBLE TAXATION RELIEF PROVISIONS

The international literature has analysed the relationship between the basis of taxation, international tax policy and the three methods used to reduce or eliminate double taxation. It has been found that optimal double taxation relief measures will be affected by whether the home and host countries are high-tax or low-tax jurisdictions. (Larkins, 2001:273-274).

3.2.1 Tax policy and double taxation relief provisions

According to Larkins (2001:235), the EM is used mostly by countries that have a source-based system of taxation. France taxes income at source and its primary method of foreign tax relief is the EM (Larkins, 2001:254). This method also favours CIN because all investors will be paying the same tax rate in the host country. EM encourages investment in low-tax jurisdictions because the investor will attain a lower overall effective tax rate compared to a similar investment domestically (Larkins, 2001:248). EM will not achieve CEN because the varying foreign tax rates will affect the investor’s final effective tax rate.

A country that grants FTCs will be applying a CEN policy because the burden of taxpayers will be the same whether they invest domestically or abroad. However, many countries impose limitations on the amount of foreign taxes that can be offset against domestic taxes (Larkins, 2001:239-245). The objective is to restrict the tax credit to the equivalent domestic tax rate. This is a disadvantage to companies investing in high-tax jurisdictions since they will not be able to eliminate all the tax that has been duplicated on foreign profits. It also results in a reduction in CEN and could discourage investment abroad owing to the higher tax cost. The FTC method will achieve CIN only where the home country is a high-tax jurisdiction.

Although Larkins (2001:273) supports a policy of CEN, he argues that a country should not follow a policy of CIN but rather adopt a policy that promotes global competitiveness (Larkins, 2001:249). By doing so, a country can evaluate its FTC mechanisms and is able to compare double taxation relief measures across countries (Larkins, 2001:248-250). He therefore proposes that countries should ease any restrictive practices in their tax legislation and even introduce *de minimis* rules for FTC (Larkins, 2001:274).

Shaviro (2010:3-4) is opposed to the use of CEN or CIN as a tax policy objective. In particular, he states that CEN is based on a consideration of global welfare and efficiency whereas a country’s policy should concentrate on the welfare of its own citizens. Furthermore, where FTCs are granted, the investor will be indifferent to varying tax rates when making a choice of location for an investment because his overall tax rate will always be the same. This does not encourage global efficiency. In comparison, if a country uses an exemption system, the investor is more conscious of foreign tax differentials.

As alternatives to the CEN and CIN principles, Shaviro (2010:2-3) proposes two margins to evaluate the optimal tax policy objective:

- the outbound investment margin; and
- the marginal reimbursement rate (MRR)

By treating foreign taxes as a deduction and reducing the tax rate on foreign source income, a country could achieve the same objective as granting FTCs. Investors would still enjoy the benefit of a lower tax rate on foreign income.

The MRR is associated with an investor's ability to engage in foreign tax planning by choosing the option to invest in high-tax or low-tax jurisdictions. Shaviro (2010:3) contends that an FTC will result in an MRR of 100% whereas a deduction of foreign taxes renders the MRR equal to the marginal tax rate (MTR). An exemption system will result in an MRR and MTR equal to zero.

The use of these two margins produces a measuring tool for tax policy. It also overcomes a problem with CEN where it is measuring pre-tax foreign income against after-tax domestic income. However, Shaviro's argument against FTCs is based on an unlimited FTC system. In practice, countries tend to limit FTCs to prevent the erosion of the revenue base. Nevertheless, recognition should be given to the fact that global trade is the order of the day and the focus on global competitiveness as a tax policy as proposed by Larkins (2001:250) may be appropriate.

3.2.2 Double taxation agreements and tax relief

Tax treaties are designed to reduce or eliminate double taxation between the two contracting states by clarifying which country has taxing rights over the taxpayer and his income. The Organisation of Economic Co-operation and Development Model Tax Convention (OECD Model) and the United Nations Model Tax Convention (UN Model) are the two models upon which most current tax treaties are based. Rigby (1991:303) has criticised the OECD and United Nations for not keeping up with current trends in taxation. He particularly mentions that no provision has been made in these models for the effects of double taxation arising from anti-avoidance provisions such as controlled foreign company legislation, transfer pricing and thin capitalisation. According to Law (2010:250), there have been some changes to these models, such as the inclusion of Article 5(3) in the UN Model which now provides specifically for a services permanent establishment. However, ambiguities can still arise when DTAs have neither been updated with the new articles nor do they clearly define the income that falls under a particular article in the agreement. For example, if the DTA, using the OECD Model, does not specifically identify the income that falls under Article 7 Business profits and Article 21 Other income, there may be a difference in interpretation between the contracting parties about taxing rights for certain types of income, such as service fees. (Law, 2010:251).

3.3 SOUTH AFRICAN LITERATURE ON DOUBLE TAXATION

The South African tax legislation contains all three methods of providing for double taxation relief. For instance, section 10B of the Act exempts foreign dividends in certain circumstances. Sections 6*quat* and 6*quin* of the Act represent the FTC method. The 5th Report on taxation by the Katz Commission (National Treasury, 1995: Para 6.4) indicated that the use of an FTC would be in line with a tax-neutral policy. Section 6*quat* also includes an element of the deduction method. In addition, section 108 of the Act provides for the incorporation of DTAs concluded between South Africa and other countries into the Act.

In the branch report on South Africa presented by Hattingh at the International Fiscal Association's 2011 annual congress, two contentious double taxation issues in this country's tax regime were highlighted (2011:576):

- the interpretation of the source of income to ascertain whether foreign taxes will be eligible for credit under section 6*quat* of the Act; and

- the inclusion of a clause in South African DTAs that causes the relief from double taxation to be “subject to” the provisions of the domestic legislation, namely section 6*quat*.

The meaning of source, as interpreted by the courts, is applied to section 6*quat* in Interpretation Note No. 18 (South African Revenue Service, 2009:10-11). Hattingh (2011:580-581) argues that the courts’ interpretation of source was not meant to establish whether income emanated from a source outside South Africa, therefore it cannot be applied to section 6*quat* . SARS (South African Revenue Service, 2009:13) responds that, aside from the new meaning being contrary to legal precedent, unilateral tax relief without reciprocity from other countries would erode the South African tax base. This line of reasoning seems to have been disregarded when section *6quin* was promulgated since it ignores the source principles entirely. The ambiguity surrounding the meaning of source has created confusion about the entitlement to FTCs, especially when there is no DTA in place.

All tax treaties since 2001 contain the clause stating that double taxation relief for South African residents is subject to the provisions of section 6*quat* of the Act. Hattingh (2011:583) questions the reason for the inclusion of such a clause. The South African legislation already gives recognition to DTAs as part of the Act by virtue of the provisions of section 108. Tax treaties have their own provisions for stipulating which foreign taxes are eligible for a credit. Furthermore, double taxation relief clauses impose their own limitations and South Africa’s DTAs specifically state which foreign taxes are covered in the treaties (Hattingh, 2011:584-585).

In Hattingh’s opinion (2011:584), the “subject to” clause appears to reduce the provisions of a DTA to a meaningless contract because SARS asserts that, where this clause exists, section 6*quat* is the only method to determine double tax relief (South African Revenue Service, 2009: 33-34).

Honiball and Killoran (2011c:32) state that the provisions of section 6*quat* which restrict a FTC to foreign taxable income will prove a hindrance to the establishment of HQCs in South Africa. The particular concern has been with management and technical fees received by the HQC. Most of it would be from a South African source and, therefore, not eligible for the FTC. This reservation has been echoed by Slenderbroek (2011:22) who points out that, in some African countries, fees of this nature are subject to withholding taxes. This increases the tax burden on investments in African countries. In addition, if the fees are partially from the foreign source and partially from South Africa, the apportionment of the fees and their attendant costs between local and foreign sources becomes difficult. The foreign taxes could be deducted against taxable income but this is less than a full tax credit.

The views above were expressed before the introduction of section 6*quin* which deals specifically with service fees that have been subject to withholding taxes. The provision was enacted to overcome the problem of African countries levying withholding taxes on management and technical fees even when they are from a South African source. It is submitted that the provisions of section 6*quin* will be limited especially when a holding company charges a management fee based on the cost of recovering expenses incurred. In these circumstances, the "net income" will be low or even nil, thus offering no relief from double taxation. Moreover, as Ndzipo (2012) points out, when a company suffers a tax loss, all foreign taxes incurred in that year will be forfeited because there is no domestic tax liability. In these circumstances, the only opportunity for tax relief is the proposal in the Draft Taxation Laws Amendment Bill 2012 (2012b:12) that taxpayers elect to deduct the foreign taxes from income in terms of section 6*quat*(1C).

Arnold (2011:33) criticises South Africa for being "unprincipled" and encouraging "bad behaviour" on the part of the African countries that impose the withholding taxes even when they are in breach of a DTA with South Africa. This can be overcome by including a provision in the tax treaty stating that the service fees are deemed to arise in the country of the payer (Slenderbroek, 2011:22). However, this would be to the detriment of South Africa because it would be surrendering taxes to which it is entitled.

In a survey on the treatment of technical service fees in 44 tax treaties concluded in 2009, Law (2010:250-251) found that such fees were normally treated as active income and the residence state of the service provider would be given exclusive taxing rights. However, if the treaty contained a service permanent establishment provision or the service provider had any element of a fixed base in the source country, then the source state would be entitled to tax the technical service fees. In some instances, the technical service fees were treated as passive income, like royalties. In such circumstances, the source state would be entitled to tax the income but at a reduced rate. This is what section 6*quin* achieves. It implicitly accepts that the source country has the right to tax the service fees and that it will then provide relief from double taxation to the resident taxpayer by granting a tax rebate on foreign taxes paid on the service fees.

Other local literature has focussed on comparisons between the South African tax regime and that of Mauritius since much of the investment into African countries has been channelled through Mauritius (Botha, 2011; Goba & Burger, 2010; Honiball & Killoran, 2011[a], [b] & [c]; Legwaila, 2010). The case for Mauritius is the special Global Business License Category 1 (GBL1) corporate structure for foreign-owned companies with its liberal FTC rules that, effectively, reduce the tax rate to 3%. The case against South Africa is the controlled foreign company (CFC) income inclusion, the taxation of capital gains and the limitations on FTCs, aside from non-tax factors such as exchange control regulations.

3.4 CONCLUSION

There has been criticism that Mauritius's aggressive tax policies create "harmful tax competition" (Legwaila, 2010:360). However, according to Lindsay (2009:14), Mauritius has never been blacklisted for its practices and has complied with OECD requirements after the OECD report on harmful tax competition.

Some commentators express surprise that emerging economies should be introducing more CFC legislation and increasing restrictions on FTCs (Tobin, 2011:39). In comparison, the trend in developed economies, such as Japan, Singapore and the United Kingdom (Landau, Tokuhiro, Muraoka & Kobayashi, 2009:15-16; Ho, 2008:118; Tobin, 2011:39), is to move towards exemptions.

The competition for scarce capital will generate competition among countries throughout the world. One of the measures to attract this capital is a tax system that has low rates and generous concessions or incentives. As Ho (2008:126) suggests, there should be a balance between policies that safeguard the revenue base of a country and those that encourage genuine business investment.

The desire by South Africa to be the financial hub of Africa has led to this country recognising that its current tax policies are not meeting its goals. This is evident from the concessions granted under the HQC provisions in section 9I of the Act and the introduction of section 6*quin* to deal specifically with the high tax burden created by withholding taxes imposed by many of the African countries. As envisaged by Larkins (2001), a tax policy of global competitiveness with greater flexibility for FTCs seems more appropriate than the traditional CEN and CIN principles.

CHAPTER 4

REVIEW OF DOUBLE TAXATION RELIEF PROVISIONS IN SOUTH AFRICA, MAURITIUS AND THE NETHERLANDS

4.1 INTRODUCTION

This is a study of the effectiveness of the double taxation relief measures available to South African companies investing in other African countries. In order to assess the efficacy of such measures, one needs to know what they are and how they compare with the methods used by other countries. In the study, the countries selected for comparison are Mauritius, another African country, and The Netherlands, a non-African country. Both countries have been chosen because of their popularity among multinational companies as jurisdictions for use as vehicles for investment abroad (Honiball & Killoran, 2011b: 36).
This chapter briefly describes the main features of the tax regimes of South Africa, Mauritius and the Netherlands and reviews the mechanisms used by each country to reduce or eliminate double taxation borne by its residents. It then compares the three countries in terms of their liberality and constraints in granting relief from double taxation.

4.2 THE SOUTH AFRICAN TAX REGIME

Sections 6*quat*, 6*quin* and 108 of the Act (South Africa, 1962) and IN No. 18 (South African Revenue Service, 2009) have been used as sources to describe the South African tax regime and its double taxation relief measures.

4.2.1 General overview

The characteristics of the South African tax system are as follows:

- It uses a residence basis of taxation.
- The corporate rate of income tax for residents is 28%.

- Withholding taxes are levied on royalty payments, dividends distributed after 1 April 2012 and interest paid to non-residents from 2013.
- It has an extensive treaty network. Currently, there are 70 treaties in force.

4.2.2 Foreign income inclusions

Foreign income that is taxable in South Africa before taking into account any provisions in double taxation agreements consists of the following:

- branch profits;
- passive income such as dividends, interest, rent and royalties;
- capital gains except for gains on immovable property situated in a foreign country;
- controlled foreign company (CFC) income (The income from the CFC which is imputed to the taxable income of the resident is based on a calculation of taxable income as if the CFC was a resident taxpayer. It is subject to certain inclusions and exclusions enumerated in section 9D of the Act.).

4.2.3 Foreign income which is exempt or excluded from South African tax

Foreign income that is exempt or excluded from being taxed includes the following:

- foreign dividends, under certain circumstances;
- CFC income derived from a company that has a foreign business establishment abroad (A foreign business establishment is defined in section 9D of the Act. The main premise is that it has a fixed place of business, such as shops, offices, a factory or warehouse. It is suitably staffed and equipped to carry on the operations of the business.);
- dividends, interest, rent and royalties received from a fellow CFC.

4.2.4 Special corporate structures

The new headquarter company regime in South Africa became effective from 1 January 2011 under the provisions of section 9I of the Act.

The characteristics of the headquarter company (HQC) are as follows:

- It is a resident for income tax purposes.
- For each year of assessment and all previous years of assessment, each shareholder (or together with another company in a group) held at least 10% of the equity shares or voting rights of the company.
- At the end of each year of assessment and all previous years, at least 80% of the tax value of the company's assets comprises equity shares in or loans to foreign companies in which the HQC owns at least 10% of the equity shares or voting rights.
- Where the gross income of the HQC exceeds R5 million, at least 50% of that gross income must comprise rent, dividends, interest, royalties or service fees payable by the foreign companies or the proceeds from the disposal of these foreign companies.
- There are no CFC inclusion rules on condition that South African residents hold less than 50% of the equity shares in the HQC.
- Any dividends distributed by the HQC will not be subject to withholding tax.
- The HQC will be treated as a non-resident company for purposes of paragraph 64B of the Eighth Schedule to the Act. This means that it will be exempt from capital gains tax on disposal of its investments in any foreign company or capital distribution that it makes.
- The HQC is treated as a non-resident in terms of the provisions of sections 42 to 47 of the Act. Therefore, it cannot utilise the benefits of deferring the payment of taxes arising from group restructures.
- Being a resident, the HQC can utilise the double taxation relief provisions of section 6*quat* and section 6*quin* as well as the benefits derived from South Africa's tax treaties for relief from double taxation.

4.2.5 Foreign tax relief

The South African foreign tax relief provisions are found in sections 6*quat* and 6*quin* of the Act. They are supported by tax treaties negotiated between South Africa and foreign jurisdictions.

4.2.5.1 *Section* 6*quat*

IN No. 18 (South African Revenue Service, 2009) sets out the circumstances under which foreign taxes qualify as a rebate against local taxes and the methods for calculating the amount of foreign tax eligible for credit.

Credits are granted on foreign taxes paid if the income received is of a similar nature to that which is taxable in South Africa and is from a source outside South Africa. (South African Revenue Service, 2009:13-16). The foreign income must be included in South African taxable income. Foreign taxes have to be proved to have been paid or payable to the foreign jurisdiction and they must not be recoverable from the foreign tax authorities.

Section 6quat(1B)(a) limits the foreign taxes that can be offset against local taxes in a particular year of assessment. It is based on the equivalent tax that would have been payable in South Africa if the foreign net income had been from a source within South Africa. “Net income” is based on gross income, less expenses. The expenses should include a portion of costs incurred in South Africa. The suggested method for apportioning local expenses of a general nature to the foreign income is that it be done on a “fair and reasonable” basis, such as turnover or gross profit (South African Revenue Service, 2009,:23). If the South African company is in a tax loss position and, therefore, not liable for income tax, no foreign tax credit will be granted in that year since there is no domestic tax against which to deduct the foreign tax.

The foreign tax eligible for credit is based on a pooling of net income and losses from all foreign sources. An exception arises where a DTA is not subject to the provisions of section 6*quat*. Then, the FTC must be calculated separately.

If the foreign taxes paid in any year of assessment exceed the amount allowed for credit against local taxes, the excess can be carried forward to the following year and offset against local taxes provided there is foreign income earned in that year. However, the amount carried forward can be utilised only after the current year's foreign taxes have been credited against local taxes first. The excess taxes may be carried forward for seven years.

If foreign taxes have been paid on income received by the taxpayer but the income is not regarded as being from a non-South African source in terms of the Act, these taxes may be deducted from the foreign income in the year in which they have been proved to be paid or payable. However, the deduction is only available for income from trade. In other words, it excludes passive income such as interest, rent and royalties.

A taxpayer cannot choose to apply a credit or a deduction for foreign taxes under section 6*quat.* This is because the credit is available only to foreign source income. The deduction is an alternative to receiving no relief from double taxation even though it represents only 28% of the foreign taxes paid.

4.2.5.2 *Section* 6*quin*

This section of the Act allows for a rebate in respect of foreign taxes withheld by a foreign jurisdiction on income derived from services provided to foreign entities. The income may be from a source within South Africa. This includes management, technical and service fees.

The same limitation rules as those applying to section 6*quat* are applied to section *6quin* for the determination of the amount of foreign tax eligible for credit in a year of assessment. It is based on the equivalent South African tax that would be payable on the net income that was subject to foreign tax.

There are certain administrative provisions for claiming a credit under this section of the Act. The taxpayer must submit a declaration to the Commissioner for the South African

Revenue Service of the amount of foreign tax levied and withheld within 60 days of the date from which the monies were withheld. If he fails to do so within the stipulated period, he forfeits the rebate.

There is no carry-forward provision in section 6*quin.* Any amount of foreign tax paid that exceeds the limit prescribed by the provisions is forfeited.

4.2.5.3 *Tax relief with or without a double taxation agreement*

The provisions of section 6*quat* and section 6*quin* are available to the taxpayer if there is no tax treaty between South Africa and the other country imposing the foreign taxes.

Where there is a double taxation agreement between South Africa and the other country, the taxpayer has two alternatives:

- The concessions for relief from double taxation granted in the double taxation agreement can be used. However, the carryover of excess foreign taxes paid to future years is prohibited unless the DTA is already subject to the provisions of section 6*quat*.
- The provisions of section 6*quat* and section 6*quin* can be utilised*.* If this option is chosen, the taxpayer has the benefit of the carrying over excess foreign taxes paid to future years.

4.2.6 Conclusion

The South African tax regime provides for all three methods of tax relief, namely, the exemption, credit and deduction methods. However, FTCs are limited by the source rule in terms of eligibility for tax credits. In addition, CFC legislation and the taxation of foreign branch profits draws more foreign income into the South African tax net. The new HQC legislation, which excludes CFC income from being taxed, eliminates some of the negative aspects of the tax legislation for foreign investment. Another source of relief for taxpayers with investments in Africa is the introduction of section 6*quin* of the Act which offers an FTC on income that has been subject to foreign taxes even though the income is not from a foreign source. South Africa’s strong tax treaty network enhances the opportunity for minimising double taxation (Honiball & Killoran, 2011a:43-44).

4.3 THE MAURITIUS TAX REGIME

Mauritius is regarded as a low-tax jurisdiction. The approach taken by the Mauritius Revenue Authority (MRA) to double taxation relief is different from the more common FTC method limited to the domestic statutory tax rate (Dabeesingh, 2012; Ernst & Young, 2011:713-721, Legwaila, 2010:197-214; Mauritius Revenue Authority, 2012).

4.3.1 General overview

The Mauritian tax regime is characterised as follows:

- It has a residence basis of taxation.
- Companies incorporated in Mauritius and other companies that have their central management and control in Mauritius are regarded as residents.
- Non-residents are taxed on income derived from a source within Mauritius.
- The corporate tax rate is 15%.
- It has a fairly extensive tax treaty network. To date Mauritius has had 36 tax treaties in force (Mauritius Revenue Authority, 2012).

4.3.2 Foreign income inclusions

Foreign income subject to tax includes:

- branch profits; and
- passive income such as dividends, interest and royalties.

4.3.3 Income not subject to tax

Income not subject to tax entails:

- dividends received from a Mauritian resident company;
- capital gains; and
- income from subsidiaries, that is, no CFC income inclusion or thin capitalisation rules.

4.3.4 Special corporate structures

According to Legwaila (2010:202-210), foreign investors wanting to establish a company in Mauritius can obtain a global business licence. There are two types, but the one most favoured for use as an intermediary holding company is the GBL1.

The requirements for a GBL1 company are as follows:

- The company must be tax resident and effectively managed and controlled in Mauritius.
- There must be a minimum of two resident directors in Mauritius and at least two of them must be present at directors' meetings.
- The company shall maintain its principal bank account in Mauritius at all times.
- It cannot hold a bank account in the local currency or transact in local currency.
- It cannot hold immovable property or certain securities in Mauritian companies.
- A global business company is permitted to transact with residents but income derived from such transactions will be taxed at the full rate of 15%.
- It can conduct certain types of business such as headquarter company operating functions, asset/fund management, trading and consultancy services.

4.3.5 Foreign tax relief

The Mauritian foreign tax credit provisions are found in section 77 of the Income Tax Act 1995 (Mauritius Revenue Authority, 1995) and the mechanisms for applying the foreign tax credit are stated in the Income Tax (Foreign Tax Credit) Regulations 1996 GN 80 of 1996 (Mauritius Revenue Authority, 1996).

The GBL1 company has several options for obtaining relief from foreign taxes paid. It can apply the methods as prescribed by the Regulations either individually or in a combination of the various types. The methods are described below.

4.3.5.1 *Underlying tax credit*

An underlying tax credit is granted where the same income has been taxed in more than one country. The liability for tax in Mauritius on the foreign income is reduced by the foreign taxes paid on that income.

In relation to dividends, recognition is given to the fact that the profits from which the dividend has been paid have already been taxed. Consequently, the Mauritian tax liability will be reduced by the tax already suffered on the profit distributed as a dividend.

The taxpayer must prove that he has paid the foreign tax or that it is payable to the foreign jurisdiction.

4.3.5.2 *Presumed tax credit*

This method of foreign tax relief is used as an alternative to the underlying tax credit method. It is presumed that 80% of the Mauritian tax liability is attributed to taxes already borne in foreign countries. The result is that the taxpayer’s effective tax rate is reduced from 15% to 3%. There is no need to supply documentary proof of how much tax was actually paid on the foreign income.

4.3.5.3 *Tax sparing credit*

This method of foreign tax relief is normally provided in tax treaties. Where a GBL1 company has an investment in a foreign country that levies taxes on profits at a rate lower than its normal statutory rate, or exempts income from tax in order to encourage investment in that country, the MRA will grant an FTC equal to the statutory tax rate of that foreign country. Therefore, Mauritius will be providing foreign tax relief in excess of the actual taxes paid.

4.3.5.4 *Withholding tax credit*

The company is entitled to claim a credit against its Mauritian tax liability for any withholding tax suffered on income received from a foreign source.

4.3.6 Conclusion

The initial appeal for setting up an IHC in Mauritius is its low tax rate, coupled with the absence of withholding taxes, capital gains tax and CFC legislation. However, the most compelling factor is the FTCs granted for foreign tax relief. In particular, the 80% presumed tax credit automatically reduces the effective tax rate of a GBL1 company to 3% without requiring the taxpayer to supply proof of foreign taxes paid.

4.4 THE NETHERLANDS TAX REGIME

The Netherlands is a preferred jurisdiction for setting up an IHC or HQC for investment abroad. The attraction lies in the large network of tax treaties that it has and the exemption from Dutch tax of foreign income, dividends and capital gains if a taxpayer has a specified minimum shareholding in the foreign company (Legwaila, 2010:173-174, Reinders, 2012).

The main characteristics of the Netherlands tax system and its double taxation relief provisions are described below (Ernst & Young, 2011: 767-785; Government of Netherlands, Belastingdienst, undated; Legwaila, 2010:164-193, Reinders, 2012).

4.4.1 General overview

The salient features of the Netherlands tax regime are as follows:

- It uses a residence basis of taxation.
- Foreign incorporated companies are treated as residents of Netherlands if they are effectively managed and controlled in the Netherlands unless a double tax treaty states otherwise.
- Non-resident companies are taxed only on income derived from a source within the Netherlands, for example, branch profits.
- For 2012, the corporate and capital gains tax rates are 20% for the first Euro 200,000 and 25% for taxable income in excess of Euro 200,000.
- Group company taxation applies. This is known as the fiscal unity regime. It provides for a tax consolidation of companies within a group where the shareholding is at least 95%. The group can file a consolidated return with the main advantage being that the losses can be offset against profits of the companies within the group.
- Withholding tax of 25% is levied on dividends.
- It has an extensive tax treaty network.

4.4.2 Foreign income inclusions

Foreign income inclusions entail

- passive income such as dividends, interest and royalties derived from a passive investment company;
- capital gains; and

- revaluation obligation. Where a Dutch company is identified as a passive investment company, it is required to be revalued to market value each year. The change in value is subject to Netherlands tax.

4.4.3 Exempt foreign income

The following amounts are exempt from income tax in the Netherlands:

- Foreign business profits derived from the operations of a permanent establishment overseas. As of 1 January 2012, the Netherlands introduced the so-called “objectvrijstelling” (Dutch object exemption). The income generated by a branch of a Dutch company is exempt from Dutch corporate income tax unless specific double tax treaties indicate otherwise.

- There is no CFC imputation of income except in relation to the abovementioned revaluation obligation for passive investment companies.

- A participation exemption is granted on income from a foreign subsidiary if a Dutch entity holds at least 5% of the nominal paid-up share capital of the subsidiary, unless the shareholding

  - is held with the objective of a being a passive investment (the shareholder’s objectives or motive test);

  - qualifies as a passive investment company (the asset test); and

  - is not subject to tax on its profits at an effective rate of at least 10% (the comparable tax test).

  The main test is the motive test and the other two are fall-back tests. However, if none of the three tests are met, the subsidiary’s income will not be eligible for the participation exemption. This provision became effective from 1 January 2012 onwards.

4.4.4 Special corporate structures

There is no distinction between an ordinary company and a holding company in the Netherlands. They are all taxed in the same manner. An ordinary Dutch company is entitled to carry back losses for one year and carry forward losses to be offset against future profits for nine years. However, there are special rules pertaining to holding and finance companies with regard to loss compensation. A specific type of company, called a co-operative, is generally not subject to the dividend withholding tax.

4.4.5 Foreign tax relief

Foreign tax relief encompasses the following:

- Tax relief for foreign taxes suffered is determined on a per-category basis of income.
- Tax relief cannot exceed the Netherlands tax owing in each category.
- Rollover relief was available where foreign losses which were incurred in the previous year could be offset against the current year's profits in the specific category of income. However, since the introduction of the Dutch object exemption on 1 January 2012 mentioned above, losses suffered by branches in a permanent establishment cannot be offset against Dutch profits.
- The nature of tax relief depends on the country from which it was received. It will be influenced by the double tax treaty, if one exists.

There are two methods of tax relief:

4.4.5.1 *Exemption method*

The two main types of exemption are:

- the Dutch object exemption for profits derived from a permanent establishment in a foreign country; and
- the participation exemption for income from a foreign subsidiary.

The income that is exempt from tax in the Netherlands also depends on the terms of the DTA with the other country, if there is such an agreement.

4.4.5.2 *Credit method*

The credit method is normally applied to dividend, interest and royalty income. The amount of the credit is limited to the tax that would have been payable on the same income in the Netherlands.

According to Reinders (2012), reference is first made to the tax treaty to determine the amount of foreign tax that should be withheld. If the income is already subject to the Dutch object exemption or the participation exemption, any withholding taxes levied on the same income or dividends will not be eligible for an FTC in the Netherlands. Otherwise, the provisions in the tax treaty will dictate how much tax relief will be available.

Where there is no DTA between the two countries, the amount of the credit will be determined by the “Besluit voorkoming dubbele belasting” or “Decree to mitigate double taxation”.

There are three methods of calculating the income to use as a basis for determining the amount of foreign tax that is eligible for a credit:

- *The gross method.* This method just utilises the gross amount of the income without deducting any costs.
- *The half-nett method.* It takes into account costs directly related to dividends, interest or royalties.
- *Nett method*. It takes into account all integral costs relating to dividends, interest or royalties.

The method to be used is determined by the provisions in the Decree to mitigate double taxation. If the FTC to be granted in one tax year is less than the actual foreign tax paid, the excess foreign taxes can be carried forward and offset against future domestic tax liabilities. This is determined by the Dutch tax authorities. They notify the taxpayer of the value of the unutilised FTCs.

4.4.5.3 *Deduction method*

The taxpayer can choose to deduct the foreign taxes paid from his Dutch income as an alternative to claiming a credit. This option would usually give less relief as it minimises the income subject to tax rather than reducing the actual tax liability.

4.4.6 Conclusion

The incentive for multinational companies to establish IHCs in the Netherlands is the low qualifying threshold of 5% for the participation exemption which excludes the income of foreign subsidiaries from being taxed in that country. The new “object exemption” effected in January 2012 also excludes foreign branch profits from a permanent establishment being taxed in the Netherlands. The end result is that the amount of income from foreign operations subject to tax in the Netherlands could be minimal. This country’s extensive tax treaty network would be particularly attractive to companies investing in Africa because it would potentially reduce the rate of withholding taxes imposed by the African countries.

4.5 COMPARISON OF TAX RELIEF MEASURES BETWEEN SOUTH AFRICA, MAURITIUS AND THE NETHERLANDS

The following analysis compares the double taxation relief measures between the three countries selected and assesses the benefits and shortcomings within them.

4.5.1 Exemption method

All three countries have exemption provisions in their legislation. Mauritius’s greatest concession is that it excludes CFC income and all capital gains from the tax net. Both South Africa and the Netherlands offer a participation exemption on income earned by foreign subsidiaries but the qualifying threshold for the exemption is significantly different. The Netherlands requires a shareholding of only 5%. In comparison, the shareholding threshold for South Africa is 20%, subject to the condition that the subsidiary has a foreign business establishment. The largest exemption available is the Dutch object exemption which excludes the profits of foreign branches that have a permanent establishment from Dutch tax. By contrast, South Africa taxes foreign branch profits and only offers relief from foreign taxes in the form of FTCs. Mauritius also taxes foreign branch profits but, with its low corporate tax rate of 15%, it still has an advantage over South Africa. Besides the specific legislative provisions, the provisions of double taxation agreements could cause other forms of income to be exempt.

The inclusion of foreign branch profits and CFC income that is not eligible for the participation exemption into South Africa's tax base could substantially increase the potential for double taxation, especially where there is no DTA with the foreign country.

4.5.2 Credit method

This method is used by all three countries.

The method applied by the Netherlands appears to be similar to the section 6*quat* provisions in the South African legislation. Nonetheless, it appears to be more restrictive in that the credit is applied to a specific category of income as opposed to the pooling of all foreign income as is done in South Africa except where a DTA excludes the provisions of section 6*quat*.

The Netherlands does not apply the source criterion for the determination of foreign-source income. Therefore, the income that is available for a foreign tax credit may be greater than that provided by the South African tax provisions. The negative impact of the source provision has been alleviated by the introduction of section 6*quin* which allows the application of an FTC against service fees charged to a foreign recipient that originate from a source within South Africa. However, it is limited by the prohibition of carrying forward excess credits to be offset against future domestic taxes on foreign income.

The South African legislation does not provide any guidelines on how to apportion costs to domestic and foreign income. The only recommendation provided by IN No 18 (South

African Revenue Service, 2009:23) is that the apportionment should be “fair and reasonable”. The Netherlands, on the other hand, prescribes one of three methods, given the particular circumstances and the terms of the tax treaty, if one exists with the foreign country.

Slenderbroek (2011: 22) questions how one apportions a service fee between local and foreign source income where services rendered to a foreign country have been provided in both countries. In addition, where service fees are based on a recovery of costs which result in a low margin, and then overhead costs are appropriated to the foreign income, the net income could be low or even create a loss. Consequently, the foreign tax eligible for credit will be minimal or even nil.

The presumed tax credit method applied by Mauritius is the most generous method. Some might consider it excessive because there is no factual basis for the 80% rate that is applied. Besides this provision, Mauritius allows the taxpayer to utilise a combination of the credit methods available. For instance, a taxpayer can claim the underlying taxes incurred on income from which a dividend has been distributed and the withholding taxes paid on the dividend. In contrast, the Netherlands and South Africa exempt the foreign income of the subsidiary by virtue of the participation exemption and they exempt the dividend received from tax but they do not grant a credit on the withholding taxes suffered. The relief from the withholding taxes may come from a DTA which could reduce the rate levied by the foreign jurisdiction.

4.5.3 Deduction method

This method is used by South Africa and the Netherlands. South Africa introduced this provision to compensate taxpayers who cannot claim FTCs because the foreign income is regarded as being from a source within South Africa. The Netherlands approach enables the taxpayer to claim a deduction when the company has a tax loss. It is the least favourable method of double tax relief because it only offers relief equal to the taxpayer’s marginal tax rate. However, it is still reducing the double tax burden rather than giving no relief at all.

4.5.4 Special corporate structures

The GBL1 company structure in Mauritius is the most attractive option offered by the three countries under review. It provides the lowest rate of tax and the greatest amount of relief from double taxation. Besides starting with the lowest corporate tax rate of 15%, compared with 20-25% for the Netherlands and 28% for South Africa, the presumed foreign tax credit provision reduces the effective tax rate to 3%. The Netherlands co-operative company is only exempt from withholding taxes levied on dividends. It is therefore very limited in minimising double taxation.

The South African HQC structure attempts to remove the provisions in the current legislation that discourage potential investors. The minimum shareholding for setting up an HQC is only 10% which is still higher than the 5% required in the Netherlands. The HQC provisions eliminate the CFC income inclusion provisions, exempt any dividend distributions from withholding tax and exclude the company from capital gains tax on the disposal of any investments in foreign companies. The first two concessions already exist in the Netherlands and Mauritius. In addition, Mauritius does not have capital gains. Therefore, South Africa is just operating on the same plane as the other two countries with no particular advantage.

The drafting of the legislation for the HQC has created a rather ambiguous structure. In some instances the HQC is treated as a resident and in others is deemed to be a non-resident, such as the exclusion from capital gains tax on disposal of shares in a foreign company. This could create some confusion. It is suggested that it would have been simpler to exempt the HQC from those provisions where it is currently treated as a non-resident.

4.5.5 Treaty networks

South Africa has been described as having an advantage over other countries wanting to invest in Africa because of its extensive treaty network (Honiball and Killoran, 2011c:29). To evaluate the effectiveness of the South African treaty network, a comparison has been made with DTAs with African countries that are common to South Africa, Mauritius and the Netherlands in Table 2 below.

Table 2: Withholding taxes payable in terms of double taxation treaties

Treaty Country	South Africa				Mauritius				Netherlands			
	Dividends	Interest	Royalties	Fees	Dividends	Interest	Royalties	Fees	Dividends	Interest	Royalties	Fees
Botswana	10/15	10	10	10	5/10	12	12.5	15	-	-	-	-
Egypt	0	12	15	-	-	-	-	-	0	0	12	-
Ghana	8	10	15	15	-	-	-	-	8	10	15	15
Lesotho	15	10	10	10	10	10	10	0	-	-	-	-
Malawi	10	0	0	0	-	-	-	-	15	0	0	15
Mozambique	8/15	8	5	-	8/10/15	8	5	-	-	-	-	-
Namibia	5/15	10	10	-	5/10	10	5	-	-	-	-	-
Nigeria	7.5	7.5	7.5	-	-	-	-	-	7.5	7.5	7.5	-
Swaziland	10/15	10	10	10	7.5	5	7.5	0	-	-	-	-
Uganda	10/15	10	10	-	10	10	10	-	0/5/15	10	10	-
Zambia	15	15	15	15	-	-	-	-	5	10	10	0
Zimbabwe	20	0	20	20	10/20	0/10	15	20	5/10	0	10	0

Source: Ernst & Young 2011 Worldwide corporate tax guide

Table 2 suggests that South Africa has not been as successful as the other two countries in negotiating the lowest withholding tax rates with their African treaty partners. Of the twelve countries selected above, only two of them, namely Botswana and Malawi, have the lowest rates with South Africa compared to Mauritius and the Netherlands. Despite the fact that Mauritius has almost half the number of tax treaties in force compared with South Africa, the more favourable withholding tax rates applied in the agreements show it, once more, to be a superior location to house an HQC or IHC (Ernst & Young, 2011:712-722).

A report by Ernst & Young (2011:781-783) indicates that the Netherlands has 94 tax treaties in force. According to Reinders (2012), the Netherlands relies heavily on its tax treaties. The preferred approach to foreign investment is to route it through a country with which the Netherlands has a DTA. Thus, it is through these agreements, where more favourable withholding tax rates are negotiated compared to other countries, that the Netherlands is able to reduce any double taxation its residents may suffer.

4.6 CONCLUSION

Each of the three countries analysed uses some form of exemption or credit method. Mauritius has the most liberal foreign tax relief provisions. The methods employed by South Africa are fairly similar to those of the Netherlands. Yet, it falls short in respect of branch profits where the only relief is in the form of FTCs compared with a complete exemption in the Netherlands. South Africa also needs to improve on reducing the rates negotiated for withholding taxes in its tax treaties if it wishes to compete with other countries for investments into Africa. As illustrated in the table above, the rates negotiated are mostly higher than those obtained by Mauritius and the Netherlands.

CHAPTER 5

CASE STUDY

5.1 INTRODUCTION

The true measure of the effectiveness of legislation is evidenced by its application to a factual situation. South Africa's double taxation relief mechanisms are to be tested in the case study that follows.

The company in this study will remain anonymous. References to the parties involved will be described as follows:

Holdco: a holding company situated in South Africa

Subco: a 100%-owned South African subsidiary of Holdco

Country A: the African country in which Foreignco is resident

Foreignco: a subsidiary of Holdco located in Country A

Investco: the ultimate holding company that has a more than 51% shareholding in Holdco

Country B: The foreign, non-African country in which Investco is a resident

5.2 BACKGROUND

Holdco is a company that is tax resident in South Africa. It has investments in several African countries, including Country A. It has a majority shareholding in Foreignco, a manufacturing operation, located in Country A. Holdco is owned, by Investco, a foreign company located in Country B.

Due to limited access to skills and resources, constraints on access to financial markets and foreign currency in Africa, Holdco sets up Subco to procure goods and services on behalf of the African subsidiaries. Subco sells the goods and services to the African operations at a modest mark-up.

When Subco provides services to Foreignco, the domestic legislation requires a withholding tax of 15% to be levied on services rendered to Foreignco in Country A. When Foreignco pays Subco for goods and services, it duly withholds the 15% tax as required by the local authorities although Country A often withholds tax on services that have not emanated from a source within Country A.

In 2008, Subco submitted its tax return to SARS and claimed a section 6*quat* credit for the services rendered to Foreignco in Country A. SARS initially accepted the claims and assessed the company on this basis. In a subsequent audit, SARS advised Subco that it was disallowing the section 6*quat* credit on the following grounds:

According to the DTA between South Africa and Country A, Article 7 on Business Profits gave South Africa the right to tax the service fees. At the same time, by virtue of the DTA, Country A was not entitled to tax the service fees, thus overriding such entitlement in its domestic legislation. SARS also stated that, in terms of section 6*quat,* an FTC could be granted only if the foreign tax was "proved to be payable". Since Country A did not have taxing rights over the service fees, the withholding tax was not payable, therefore not eligible for an FTC. SARS advised Subco to apply to Country A's tax authorities for a refund of the withholding taxes paid.

Subco approached Country A for the tax refund under dispute. Country A acknowledged that the provisions of a DTA normally have precedence over domestic laws. However, the domestic tax legislation contains a proviso which states that domestic law overrides a DTA where 50% or more of the underlying ownership of the company claiming the refund is held by an entity that is not a resident of the other contracting state that is a party to the tax treaty. In this case, Country A asserted that Subco was ineligible for a refund of the withholding taxes because it was ultimately held more than 50% by Investco, a company not resident in South Africa.

The only remedy remaining to Subco was to request the South African tax authorities, in terms of the DTA's mutual agreement procedure, to engage with Country A to resolve the dispute. To date, the issue has not been settled and Subco has had no relief from the double taxation that it has endured.

5.3 APPLICATION OF DOUBLE TAXATION RELIEF PROVISIONS OF MAURITIUS AND NETHERLANDS TO THE CASE STUDY

The circumstances of the case study above demonstrate the outcome for the taxpayer of applying the South African double taxation relief provisions. Consideration is now given to the options available to Subco if it were a company located in Mauritius or the Netherlands.

5.3.1 The Mauritian solution

In Mauritius, Subco would most probably be a GBL1 company. The service fees would be subject to Mauritian tax at a rate of 15%. The company would be able to claim the presumed tax credit of 80% of the Mauritian tax, thus reducing its effective tax rate to 3%. It would also be entitled to claim the withholding taxes paid to Country A. This would reduce Subco's tax liability below 3% and, more than likely reduce Mauritian tax payable to nil.

A scrutiny of tax treaties between Mauritius and other countries shows that any income, be it business profits or other income, is taxable in the state in which the person earning the income is resident unless the income arises from a permanent establishment in the other country. In the Mauritius-Botswana DTA, there is a separate article for management, consulting and technical fees. Botswana may impose a tax but there is a limit on the amount of the tax. Therefore, in relation to the case study, Mauritius would have the right to tax the service fees and Country A would be permitted to impose a withholding tax but the rate would be capped. Mauritius would still provide the double taxation relief as described above. With regard to the breach of the DTA by Country A, Mauritius also includes mutual agreement procedures and non-discrimination clauses for resolution of disputes in its treaties. Nevertheless, according to Dabeesingh (2012) when interviewed, the Mauritian tax authorities would still afford Subco a deduction of the presumed tax credit and the withholding tax paid, thus applying the unilateral tax relief provisions. The outcome would still be the same if the underlying ownership provision pertaining to Investco was invoked by Country A.

5.3.2 The Netherlands solution

The approach by the Netherlands would be to look to the tax treaty first to determine who has taxing rights on the service fees. A review of the existing Netherlands DTAs suggests that the only withholding tax which the Netherlands allows with its treaty partners is dividends (Ernst & Young, 2011:781-782). If this were true for a DTA with Country A, the other country would not be entitled to levy withholding taxes unless it had taxing rights on service fees. If Country A had the taxing rights, the Netherlands would grant an FTC subject to the limitations in its legislation. With respect to the breach of the DTA or disregard for it due to the underlying ownership provisions, the Netherlands would institute the mutual agreement procedures. Alternatively, it could terminate the agreement.

5.4 CONCLUSION

Comparing the outcomes of the double taxation relief offered by the three countries shows that the greatest benefit is offered by Mauritius. Aside from the low corporate tax rate, the application of multiple forms of tax credits, particularly the presumed tax credit, ensures that most of the foreign taxes paid will be offset against Mauritian tax.

There appear to be minimal differences between South Africa and the Netherlands. The Netherlands has a slight advantage in that its corporate tax rate is less than that of South Africa. The other distinctions would come about in terms of the DTAs and whether the Netherlands would still grant an FTC on the withholding taxes even if this was in breach of the tax treaty. One must also bear in mind that the case study occurred before the inception of section 6*quin*. If this provision applied, some of the foreign tax would be subject to a credit but the amount would be small, given the low margin earned on the fees.

CHAPTER 6

ANALYSIS OF THE EFFECTIVENESS OF THE DOUBLE TAXATION RELIEF PROVISIONS IN SOUTH AFRICA

6.1 INTRODUCTION

The literature, the case study and discussions held with local tax experts reveal the status of the double taxation relief measures in the South African tax regime. This chapter analyses the situation, giving emphasis to the unique challenges presented by companies investing in Africa.

6.2 DATA ANALYSIS

The analysis considers the question of South Africa's ability to lighten the double tax burden of its residents by examining the unilateral methods of double tax relief and the bilateral method of tax treaties.

6.2.1 Unilateral tax relief

South Africa uses both the exemption method and the FTC method to provide double tax relief. The exemption method excludes foreign income from taxation such as foreign dividends and CFC income from a foreign business establishment. There are problems with the treatment of foreign branch profits where there is no DTA with the foreign country. South Africa taxes these profits and only offers an FTC for relief from double tax. In addition, branch losses cannot be offset against South African income. In comparison, if there is a DTA, a branch located in a foreign country will be exempt from South African tax since the company has a permanent establishment in the foreign jurisdiction. The more equitable approach would be to follow the Netherlands which exempts income from a branch that has a permanent establishment in a foreign country.

Foreign tax credits are available primarily under section 6*quat* of the Act. Hattingh (2011) opposes the inclusion of the source rule in section 6*quat* on the grounds that the interpretation given by the courts is not appropriate. Honiball (2012) concurs and recommends that the source rule be abolished. Foster (2012) maintains that there is no foreign tax relief for a company where the foreign tax is not recognised by SARS as a tax on income. Moreover, there is no FTC when the South African company has a tax loss and therefore is not liable for tax.

Even though excess foreign taxes can be carried forward and offset against the tax associated with future foreign taxable income for a period of seven years, the likelihood of exhausting all foreign taxes is minimal (Hattingh, 2011:591). The credits brought forward can be utilised only after the credit for the current year has been used up. Unless the foreign taxes originate from a low tax jurisdiction, there will always be surplus credits to carry forward, especially if they are withholding taxes. For instance, for a 15% withholding tax to be fully eliminated, a profit margin of 53% on the income would be required to equate to a South African tax rate of 28%. The attainment of such a profit after apportioning overhead costs is doubtful. The only opportunity to curtail the loss of FTCs occurs when all foreign income is pooled. Then, the high withholding taxes can be absorbed by the under-recovery of FTCs from the low taxed foreign income.

A common practice, which is confirmed by the tax practitioners interviewed, is for South African companies to gross up management and technical fees to compensate for the withholding taxes levied on them by African countries. Pearson (2012) contends that this policy just increases the fees and the corresponding taxes which could lead to the company involved being uncompetitive. It is often perceived to be the only option for smaller companies engaged in cross-border trade with African countries where the income is deemed to be from a source within South Africa. They cannot afford to bear the negative cash flow effects until they have been assessed for income tax in South Africa. Besides, there is no guarantee that they will recover all the withholding taxes paid.

According to an official from a multinational company, management fees are used as a way of extracting pre-tax profits from the foreign subsidiary and there is not always a correlation between the fees levied and the services rendered. As Foster (2012) indicates, the charging of excessive management and technical fees could give rise to transfer pricing issues, especially where contracts include a gross-up clause to cover the withholding taxes. Some African countries are beginning to question the justification for high management fees and are even disallowing the grossed-up amount as a deduction from income for the foreign subsidiary that incurred the expense.

Aside from the withholding taxes not being eligible for a section 6*quat* credit on account of the source rule, the South African legislation does not provide for foreign tax rebates where a transfer pricing adjustment has been made to the resident's taxable income (Hattingh, 2011:576). Therefore, the taxpayer carries the dual burden of being taxed in the foreign country as well as domestically.

All the experts interviewed have welcomed the inclusion of section 6*quin* to assist those companies with operations in Africa that have been subjected to high levels of withholding taxes without any relief from section 6*quat* on account of the source rule. The problems have been exacerbated when African countries that have DTAs with South Africa ignore the taxing rights of South Africa in the agreements and still impose the taxes. This was demonstrated in the case study where the taxpayer could not get any relief from double taxation because the foreign country had no right to tax the service fees. The specialists would prefer to include the option to carry forward excess foreign taxes to be credited against local taxes on future foreign taxable income.

The normal procedure to follow, if a resident taxpayer cannot recover the taxes from the offending state, is for the local authorities to enter into discussions with the other state. South African DTAs have a mutual agreement procedure which they should be exercising in these circumstances. One can only assume that any attempts along these lines have been largely unsuccessful. Hence the need to introduce section 6*quin* which is contrary to the normal source rules for claiming a foreign tax credit.

In a discussion with Charles Makola of National Treasury (2012), he disagrees with commentators who view section 6*quin* as a threat to South Africa's tax base. He maintains that National Treasury cannot prejudice taxpayers where the relevant authorities have not addressed the infringements of tax treaties with the other contracting parties. He is of the opinion that section 6*quin* is merely a cash flow problem for taxpayers. When the foreign authorities refund the taxes that should not have been deducted, the FTCs granted under this provision will be reversed. He also intimated that this provision should have less relevance in the future when South Africa increases its treaty network and ensures that the other contracting parties comply with the treaty provisions. This provision will still be of value whenever there is no DTA with the foreign country.

The calculation of foreign taxable income to determine the amount of the qualifying FTC is a practical problem. As mentioned by Pearson (2012), for companies that derive income from several foreign countries, it is difficult to apportion costs between South African and foreign sources. The task is more onerous for small companies that do business in Africa but do not have the expertise to perform the calculation. They are more likely to abandon a claim for a credit and opt to inflate their charges to recover the foreign tax. The policy of the Netherlands, which has specific guidelines on how to allocate costs to foreign income, would be more satisfactory and give greater clarity on the amount and type of costs to allocate to foreign income.

With reference to the literature, the HQC provisions in the Act are inadequate (Goba & Burger, 2010:6-7, Honiball & Killoran, 2011c:29-32). Honiball (2012) proposes the elimination of the exit capital gains tax and taxes on fees, royalties and interest. Kruger (2012) considers that it would be useful to allow existing South African resident companies to restructure so that they become part of the HQC regime. Makola (2012) indicated that, in setting up the HQC regime, it was National Treasury's intention to attract foreign investors in order to increase the tax base. By allowing resident companies to convert to an HQC, it would probably do the opposite. Pearson (2012) has criticised the drafting of the legislation. He describes it as a "moving target" with the continual changes in the provisions. This creates uncertainty about the relevance of provisions over time. The qualification criteria have to be tested regularly and, if a company fails the HQC test, it will fall out of the regime permanently. He also points out that the HQC provisions are scattered throughout the legislation. Consequently, it becomes difficult to ensure that all provisions pertaining to the HQC have been addressed. He recommends that the HQC regime be brought under one section. In contrast, the Mauritian tax rules are simple and stable, thus creating certainty about the HQC legislation.

6.2.2 Bilateral tax relief

South Africa is regarded as having one of the most extensive tax treaty networks in Africa. Despite this, South Africa does not seem to be able to negotiate the most favourable terms for its residents. This is illustrated in Table 2 where a comparison is made of withholding taxes levied in DTAs between African countries and South Africa, Mauritius and the Netherlands respectively.

In Hattingh's (2011:584) report, he asserts that the inclusion of a clause that makes a DTA subject to the section 6*quat* provisions of the Act renders the agreement worthless. There is also confusion as to which takes precedence, the DTA or section 6*quat.* This is illustrated in the case study. SARS applied the provisions of the DTA to determine which country had taxing rights over the service fees charged to the foreign subsidiary. This meant that the normal source rules in section 6*quat* were ignored. Therefore, when services were rendered in the foreign country, no credit was available for that income. Consequently, the taxpayer was worse off than if he had applied this provision. Yet, the DTA was "subject to" section 6*quat.* In section 6*quat*(2), the taxpayer can elect to apply the section 6*quat* provisions or utilise those of the DTA. SARS further states in IN No. 18 (South African Revenue Service, 2009:33) that, if an election is not made, SARS automatically uses section 6*quat*. In the case study, the taxpayer utilised the provisions of section 6*quat* when submitting the tax return for the company. This implies that he made an election in favour of the domestic legislation. Nevertheless, SARS ignored the choice made and applied the terms of the DTA. The intention of a DTA is to place a taxpayer in a better position than he would be under the domestic legislation. This was not the case in this particular situation. It is evident that some clarity needs to be given to the position of section 6*quat* if included in a DTA.

The case study also illustrates the ineffectiveness of dispute resolution under South Africa's tax treaties. The relevant DTA included a mutual agreement procedure which was intended to facilitate the settlement of disputes between the two taxing authorities. The application of the procedure in practice is unsatisfactory with the taxpayer remaining aggrieved and without any relief from double taxation.

In the opinion of Foster (2012), many of the DTAs currently in force are old and exclude specific provisions such as those for “other income”. This leads to difficulties in the interpretation of the right to tax different types of income. For example, the DTA with Zimbabwe was signed in 1965 and has not been updated since then. Of the 19 South African DTAs with African countries, eight of them came into force before 2000 (South African Revenue Service, undated). Therefore, they would not incorporate any updates of the OECD model since then, such as the provision for arbitration in Article 25 and the elimination of double taxation by contracting parties where adjustments to tax have been made for transfer pricing in Article 7 (OECD, 2010).

6.3 CONCLUSION

The analysis shows that, although there is general satisfaction amongst tax practitioners with the legislation for relief from double taxation, there are still several shortcomings. The source provision in section *6quat* reduces the amount of the FTC that can be claimed. Although there is the opportunity to deduct the foreign taxes not eligible for a rebate, this option is less attractive than a full credit. In addition, where foreign taxes have been incurred in high tax jurisdictions or mainly comprise withholding taxes, they give rise to excess credits which are unlikely to be completely utilised. However, the introduction of section 6*quin* is a welcome relief to those companies enduring high levels of withholding taxes on management and technical fees that have a source in South Africa.

There is still some ambivalence about the relationship between the domestic legislation and a DTA when the DTA is subject to the provisions of section 6*quat.* In addition, the application of the provisions of a tax treaty can leave the taxpayer worse off than if the provisions of section 6*quat* were applied. Such a result defeats the object of a tax treaty.

Although South Africa has an extensive treaty network in Africa, its treaties are not competitive. This would affect a company’s decision on the route for investment into an African country. The South African authorities also need to enforce the terms of tax treaties. Otherwise its residents are at a disadvantage.

CHAPTER 7

CONCLUSION

7.1 INTRODUCTION

The main factor in a company's resolve to invest in a foreign country is the after-tax return it will achieve. The tax regime of the foreign country in which it invests has a significant influence on the investment choice. Equally, the impact of the domestic tax legislation on its investment affects the business decision. South Africa has stated its intention is to be the financial hub for investment into Africa. To this end, it has modified the tax legislation to be compatible with this objective. The purpose of this study has been to assess the effectiveness of the double taxation relief measures offered by South Africa, particularly for resident companies investing in African states.

7.2 SUMMARY OF FINDINGS

This study has examined the current double taxation relief provisions in South Africa, compared it with those provided by Mauritius and the Netherlands and evaluated their effectiveness by observing the outcomes when they were applied to a case study.

A mismatch in the legislation is the treatment of branch profits. If there is no DTA with the foreign country, all profits are taxed in South Africa with a foreign tax credit only available for double taxation relief. In contrast, if there is a DTA in place, the branch will be treated as a permanent establishment in the foreign country and it will be given sole taxing rights.

The analysis suggests that an obstacle in the legislation is the section 6*quat* requirement that a rebate be granted only on foreign taxes paid on income that originates from a source outside of South Africa. There is also a limitation on the amount of foreign tax that can be credited in any one year. The credit is greatly reduced if the foreign taxes come from high-tax jurisdictions or are withholding taxes. South African companies that have investments in African countries have suffered most in this respect.

The extent of double taxation relief is diminished when a tax treaty extends the taxing rights to South Africa beyond those allowed in terms of the unilateral double taxation relief provisions. In addition, where foreign jurisdictions disregard the terms of a tax treaty and impose taxes to which they are not entitled, the double tax burden is greater. Some measure of relief has been obtained in the form of the section 6*quin* provision which ignores the source rule and allows for foreign tax credits on management and technical fees that have been subject to withholding taxes in foreign countries.

The policy of grossing up management and technical fees to cover withholding taxes is not a prudent option. A company exposes itself to transfer pricing penalties, particularly where cross-border trade takes place within group companies. The South African tax legislation does not relieve the taxpayer from double taxation if a transfer pricing adjustment is effected to his taxable income, even if there is a DTA in place. The OECD disagrees with this position.

The comparison of double taxation relief measures between South Africa and Mauritius indicates that the low Mauritian tax rate, the automatic 80% FTC for foreign taxes paid, and the absence of withholding taxes and capital gains tax, still renders Mauritius a more appealing option for investment into Africa. The analysis of the Netherlands tax regime demonstrates the benefits of a wide treaty network and a low threshold for the participation exemption to attract IHCs and HQCs.

The introduction of the new HQC regime offers concessions to reduce double taxation. However, it is not to the benefit of existing tax residents. The strategy of National Treasury is to attract foreign investors to broaden the tax base. In the view of local commentators, it still needs some refinement and cohesion.

7.3 CONCLUSIONS

The inability of South African resident companies to benefit from the double taxation relief measures currently in place has had some repercussions. Although the experts agree that withholding taxes imposed by foreign governments merely constitute another cost of doing business, particularly in Africa where such taxes are an easy source of revenue and cash, they have a significant influence on a company's decision about where to locate its investment in a foreign subsidiary. The strategy for South African companies has been to set up intermediary holding companies in other jurisdictions that lessen the tax effect on their investments. One of the favoured locations for such structures is Mauritius.

Although it is acknowledged that South Africa cannot compete with Mauritius, in terms of either the corporate tax rate or the generous foreign tax credit provisions, it can learn a few lessons from the Netherlands, particularly regarding the effective use of tax treaties to reduce double taxation. If South Africa intends to increase its tax treaty network in Africa, it can be beneficial to residents only if the South African authorities are aggressive in negotiating for reduced withholding tax rates and enforcing compliance with the agreements.

SARS has been labelled nationalistic in its policies (Hattingh, 2011:576). National Treasury, on the other hand, seems to take a more lenient stance especially with respect to its ambition to be a significant role player in the African region. However, the tendency to enact complex legislation to close loopholes that are perceived to deplete the tax base is counterproductive. The question is asked why SARS does not apply the anti-avoidance provisions which were revised in 2006. No cases have yet been tried to test their effectiveness.

The current international literature shows that countries are moving towards more expansive policies for double taxation relief provisions. Many of them are opting for exemptions instead of FTCs. The change in legislation by the Netherlands regarding branch profits is an example. If South Africa plans any changes to these provisions in the future, it should take cognisance of this trend.

7.4 RECOMMENDATIONS AND FUTURE RESEARCH

The inequitable treatment of foreign branch profits between unilateral and bilateral double tax relief measures needs to be addressed. A branch, by its nature, is a permanent establishment. Therefore, such profits should be exempt from tax under all circumstances in South Africa, whether there is a DTA with the foreign country or not. Conversely, branch losses should not be offset against South African taxable income.

SARS should allow for a tax credit in the event of a transfer pricing adjustment, both unilaterally and if such a provision is not specifically included in the DTA. Currently, there are no such provisions. The omission negatively affects the taxpayer who has already incurred foreign tax on the same income.

The proposed amendment to section 6*quat*(1C) in the Draft Taxation Laws Amendment Bill 2012 (2012b:12) stating that residents elect the alternative of a tax deduction rather than a credit should be accepted, provided that the option is available when the company has a domestic tax loss. This would increase the tax loss but it secures the recovery of some of the foreign tax sooner than carrying forward the credit to future years, which may never be utilised. As compensation to SARS for such a concession, the carry-forward period could be reduced to five years.

A further proposal by SARS in the Draft Explanatory Memorandum on the Taxation Laws Amendment Bill 2012 (2012a:115) that the scope for claiming an FTC under section 6*quin* be widened, is also supported. The intended change would include taxes actually paid as opposed to the current “proved to be payable” requirement. The purpose is to address the anomaly where taxes paid on income from a foreign source are excluded from an FTC in terms of a tax treaty because South Africa has taxing rights and the result is a less favourable to the taxpayer than if the unilateral tax relief provisions were applied.

The method of calculating foreign taxable income, particularly the allocation of costs, should be more definitive. It is suggested that SARS introduce some prescriptive guidelines, as is done in the Netherlands. With particular reference to management and service fees that are subject to withholding taxes, it is proposed that SARS allow the taxpayer to use a margin determined by its transfer pricing policy. This could encourage the taxpayer to desist from grossing up services fees and reduce exposure to transfer pricing problems.

For small companies that do not have a permanent establishment in a foreign country but trade in Africa, it is proposed that a *de minimis* rule be introduced without carrying forward any excess credits. For example, if the minimum rebate was 10%, and the withholding tax incurred was 15%, this would be equivalent to the South African tax that would have been incurred if the 15% withholding tax had been deducted. This option eliminates the complexities of calculating "foreign taxable income", guarantees the taxpayer certainty that he will get some relief from the foreign taxes he has paid in the same year in which they were incurred and it reduces SARS's need to audit FTC claims.

The basic model used by SARS for structuring DTAs needs to be reviewed Given that management and technical fees are such contentious issues when dealing with African countries, it is recommended that future tax treaties include a provision such as the Article 5(3) Services Permanent Establishment provision in the UN Model as reported by Law (2010:250). In order to strengthen the article to resolve disputes, the agreement should include Article 25(5) of the OECD model which provides for arbitration where the mutual agreement procedure has not been resolved within two years (OECD, 2010). It has already been implemented in the European Union (Bell, 2011:400).

Further study needs to be done to establish the degree to which South African companies are affected by unutilised foreign credits and how much is forfeited. The survey that is proposed in the Draft Taxation Laws Amendment Bill of 2012 with the statistics gathered from submissions for the application of section 6*quin* should provide some indication of the extent of the problem.

The case study gave an indication of the inadequacies in the current South African double taxation relief provisions. However, further expanded quantitative research should be conducted to assess the extent of the deficiencies.

LIST OF REFERENCES

Arnold, B.J. 2011. A tax tourist in South Africa. *TaxTalk Magazine*, 2011:30-33.

Bell, K.A. 2011. BNA International transfer pricing forum examines MAP and arbitration procedures. *Tax Management Transfer Pricing Report,* 20(10):400-402.

Botha, P. 2011. *An analysis of low tax jurisdictions as a means of increasing foreign direct investments from a South African point of view.* Unpublished master's dissertation. Pretoria: University of Pretoria.

Dabeesingh, R. 2012. Telephonic discussion and e-mail correspondence with the author between 17 and 23 August 2012, Durban. (Transcript / notes in possession of the author.)

Edward Nathan Sonnenbergs. 2010. *Expansion into Africa.* [Online] Available from: https://www.saica.co.za/integritax/2010/1860_Expansion_into_Africa.htm [Accessed: 2012-01-20].

Ernst & Young. 2005. *Foreign taxes: cost of doing business outside South African borders.* [Online] Available from: https:/www.saica.co.za/integritax/2005/1273_Foreign_taxes_cost_of_doing_business....htm [Accessed: 2012-01-20].

Ernst & Young. 2011. *2011 Worldwide corporate tax guide.* Ernst & Young.

Foster, M.C. 2012. Verbal communication with the author on 13 August 2012, Durban. (Transcript in possession of the author.)

Goba, K. & Burger, A. 2010. Tax benefits to housing your headquarters in SA? *Moneyweb's Taxbreaks,* August 2010: 6-7.

Government of Netherlands, Belastingdienst. Undated. [Online] Available from: http://www.belastingdienst.nl/wps/wcm/connect/bldcontenten/belastingdienst/ [Accessed: 2012-01-11].

Hattingh, J. 2011. IFA Branch report presented at the 65th Congress of the International Fiscal Association, Paris, 11-16 September 2011. In: Blanluet, G. Durand, P.J. *et al. Key practical issues to eliminate double taxation of business income*. IFA Cahiers de Droit Fiscal International 96b, The Hague: Sdu Uitgevers, 575-597.

Ho, K.C. 2008. The exemption regime for foreign-source business income: an international comparison. *Asia Pacific Tax Bulletin,* 14(2):118-127.

Honiball, M. & Killoran, R. 2011a. Is Mauritius still better than South Africa for headquarters purposes? *Tax Professional*, Aug/Sep 2011:42-44.

Honiball, M. & Killoran, R. 2011b. The new South African headquarter regime. *Professional Accountant,* Dec/Jan 2011/12:36-38.

Honiball, M. & Killoran, R. 2011c. The new South African headquarter regime doesn't quite cut it. *Without Prejudice,* 11(1):29-32.

Honiball, M. 2012. Written response to questions sent to the author on 23 August 2012. Durban (Copy in possession of author.)

Kruger, D. 2012. Telephonic discussion with the author on 17 August 2012. Durban (Transcript in possession of the author.)

Landau, T., Tokuhiro, T., Muraoka, K. & Kobayashi, S. 2009. Japan issues proposed 2009 tax reforms. *Journal of International Taxation,* 20(3):15-16, 19.

Larkins, E.R. 2001. Double tax relief for foreign income: a comparative study of advanced economies. *Virginia Tax Review*, 21(2), Fall 2001:233-275.

Law, S.B. 2010. Technical services fees in recent tax treaties. *Bulletin for International Taxation,* 64(5), May 2010:250-252.

Legwaila, T. 2010. *The suitability of the South African corporate tax regime for the use of South African resident intermediary holding companies.* Unpublished doctoral thesis. Pretoria: University of Pretoria. [Online] Available from http://upetd.up.ac.za/thesis/available/etd-05222010-170510 [Accessed: 2012-03-11].

Lindsay, M. 2009. Pragmatic regulation boosts competitiveness of island state. *Hedge Funds Review*, May 2009:14-16.

Lokken, L. 2011. What is this thing called source? *International Tax Journal*, May-June 2011:25-31.

Makola, C. 2012. Telephonic discussion with the author on 27 August 2012. Durban. (Transcript in possession of the author).

Mauritius Revenue Authority. 1995. Income Tax Act 1995 (Consolidated Version) with amendments up to 15 July 2011. [Online] Available from: http://mra.gov.mu [Accessed 2012-08-14].

Mauritius Revenue Authority. 1996. The Income Tax (Foreign Tax Credit) Regulations 1996 GN 80 of 1996 – 20 July 1996. [Online] Available from: http://mra.gov.mu [Accessed 2012-08-14].

Mauritius Revenue Authority. 2012. [Online] Available from: http://mra.gov.mu [Accessed 2012-08-14].

National Treasury, Republic of South Africa, 1995. *Katz Commission 5th Report – Basing the South African income tax system on the source or residence principle – Options and recommendations.* [Online] Available from: http//:www.treasury.gov.za/publications/other/katz/5.pdf [Downloaded: 2012-06-19].

National Treasury, Republic of South Africa 2010. *Taxation Laws Amendment Bill, 2010.* Media statement issued on 10 May 2010. [Online] Available from: http//www.treasury.gov.za/comm_media/press/2010/2010051001.pdf [Downloaded: 2012-03-18].

National Treasury, Republic of South Africa 2011. *Taxation Laws Amendment Bill, 2011: General Overview.* Media statement issued on 2 June 2011. [Online] Available from http//www.sars.gov.za/home.asp?pid=5980 [Accessed: 2012-03-13].

National Treasury, Republic of South Africa 2012a. *Draft Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012,* 5 July 2012. [Online] Available from: http://www.treasury.gov.za/public%20comments/TLAB/DRAFT%20Explanatory%20Memorandum.pdf [Downloaded: 2012-08-01].

National Treasury, Republic of South Africa 2012b. *Draft Taxation Laws Amendment Bill, 2012,* 5 July 2012. [Online] Available from: http://www.treasury.gov.za/public%20comments/TLAB/draft%20TLAB%202012%20for%20public%20comment.pdf [Downloaded: 2012-07-08].

Ndzipo, M. 2012. Service fees and related foreign tax credit. *Ernst & Young Tax Alert,* [Online] Available from: http://www.ey.com/ZA/en/Services/Tax/2012---June-July---Corporate-Inc [Accessed: 2012-08-16].

Organisation for Economic Co-operation and Development, 2010. *Articles of the OECD Model Tax Convention on Income and Capital.* [Online] Available from: http://www.oecd.org/tax/taxtreaties/47213736.pdf [Accessed: 2012-08-29].

Olivier, L. & Honiball, M. 2010. *International Tax - A South African Perspective 2008.* 4th ed. Cape Town: SiberInk.

Pearson, B. 2012. Interview with the author on 21 August 2012. Durban. (Transcript in possession of the author.)

Reinders, R. 2012. Telephonic conversation and e-mail correspondence with the author between 14 and 22 August 2012. Durban. (Transcripts / notes in possession of the author.)

Rigby, M. 1991. A critique of double tax treaties as a jurisdictional coordination mechanism. *Australian Tax Forum,* 8(3):301-347.

Shaviro, D. 2010. Rethinking foreign tax credibility. *SSRN Working Paper Series,* No. 10-30, July 2010:1-21.

Slenderbroek, F. 2011. Hidden tax costs of doing business in Africa. *TaxTalk,* May/June 2011:22.

South Africa. 1962. Income Tax Act No. 58 of 1962. [Online] Available from: http:/www.sars.gov.za/LNB/MyLNB.asp [Accessed: 2012-05-02].

South Africa. 2011. Taxation Laws Amendment Act No. 24 of 2011. [Online] Available from: http://www.sars.gov.za/Tools/Documents/DocumentDownload.asp?FileID 74311_134927Act24.pdf [Downloaded: 2012-03-18].

South African Revenue Service. 2009. Interpretation Note No. 18 (Issue 2): *Section 6quat Rebate or Deduction for Foreign Taxes on Income.* 31 March 2009. [Online] Available from: http//www.sars.gov.za/home.asp?pid=5886 [Downloaded: 2010-11-11].

South African Revenue Service. Undated. *International Treaties and Agreements – Double Taxation Agreements.* [Online] Available from: http://www.sars.gov.za/home.asp?pid=3919. [Accessed: 2012-05-06].

Spamer, S. & Buttrick, D. 2011. Investing into Africa directly, or via Mauritius (Part 1). *Moneyweb's Taxbreaks*, December 2011:6-8.

Spamer, S. & Buttrick, D. 2012. Investing into Africa directly, or via Mauritius (Part 2). *Moneyweb's Taxbreaks,* January 2012:5-6.

Tobin, J.J. 2011. Down the BRIC road. *Tax Management International Journal,* 2011:39-41.

Appendix A: Informed consent form

UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA
Faculty of Economic and Management Sciences

Informed consent for participation in an academic research study

Department of Taxation

THE EFFECTIVENESS OF THE SOUTH AFRICAN DOUBLE TAXATION RELIEF PROVISIONS FOR SOUTH AFRICAN COMPANIES INVESTING IN OTHER AFRICAN COUNTRIES

Research conducted by:

Ms EL de Souza Drummond (10654195)
Cell: 084 569 9168

Dear Respondent

You are invited to participate in an academic research study conducted by Elizabeth Lucy de Souza Drummond, a master's student in the Department of Taxation at the University of Pretoria.

The purpose of the study is to evaluate the effectiveness of the tax relief provisions used to reduce double taxation incurred by South African resident companies when they invest in other African countries.

Please note the following:

- This study involves an interview. Neither you nor your company will be identified in the dissertation unless you give specific permission for this. The answers you give will be treated as strictly **confidential**.
- Any recordings either electronic or in the form of transcripts will be stored securely.
- Your participation in this study is very important to us. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- The results of the study will be used for academic purposes only and may be published in an academic journal. We will provide you with a summary of our findings on request.
- Please contact my supervisor, Mr PO Manyaka: (Cell: 071 238 4732; e-mail: phuleng.manayaka@za.abb.com) if you have any questions or comments regarding the study.

Please sign the form to indicate the following:

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

__________________________ ____________________

Respondent's signature **Date**

Appendix B: Interview schedule

E L DE SOUZA DRUMMOND
SN 10654195

THE EFFECTIVENESS OF THE SOUTH AFRICAN DOUBLE TAXATION RELIEF PROVISIONS FOR SOUTH AFRICAN COMPANIES INVESTING IN OTHER AFRICAN STATES

Research for

MCom (TAXATION) degree

in the

Faculty of Economics and Management Sciences

at

University of Pretoria

INTERVIEW SCHEDULE

1. What approach do your clients use to invest in African countries, that is do they invest directly or through another country?

2. What are the key factors that determine the route for investment?

3. What tax-related factors influence the decision about how to invest in an African country?

4. Do you regard foreign taxes as just another cost of doing business abroad or as an increase in the overall tax burden of a company? What is the reason for your opinion?

5. What changes, if any, do you think should be made to the section 9I headquarter company provisions to reduce double taxation and make South Africa a more attractive location for headquarter and intermediary holding companies investing into Africa?

6. Are the current section 6*quat* and section 6*quin* provisions effective enough to reduce double taxation?

7. (a) What is your opinion of the need to calculate foreign "taxable income" to qualify for the section 6*quat* and section 6*quin* rebates and the method recommended by Interpretation Note No. 18?

   (b) To what extent is the foreign "taxable income" formula affecting the claim for a rebate or causing foreign tax rebates to be forfeited?

   (c) What alternatives would you recommend to determine foreign "taxable income"?

   (d) What do you think of granting the full amount of a withholding tax as a section *6quat* rebate (which is at a lower rate than the tax rate) in lieu of calculating the foreign "taxable income"?

8. What is your opinion of having a *de minimis* rule for foreign tax credits?

9. What is your opinion of the current section 6*quin* provisions to mitigate the withholding taxes charged by some African countries on management, technical and service fees?

10. What is your opinion of "grossing up" services fees to compensate for foreign withholding taxes payable on such fees and thus reduce double taxation?

11. Are the DTAs that South Africa has with African countries effective enough in reducing or eliminating double taxation?

12. What other measures would you recommend to reduce or eliminate double taxation suffered by South African companies investing in other African countries?