THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

SAMPLE EXAM

MODULE 2.12 – SOUTH AFRICA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

South African income tax implications for Bob

South Africa imposes tax on the worldwide income and capital gains of its tax residents. To address the position where residents structure their earnings through foreign companies, the Income Tax Act no 58 of 1962 (the Act or the ITA) has controlled foreign company legislation (CFC).

A CFC is defined as a foreign company where South African residents own more than 50% of the voting or participation rights; or a foreign company where the financial results are reflected in the consolidated financial statements of a South African tax resident company under IFRS 10 other than a headquarter company. A participation right is defined as the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share, or any interest of a similar nature, in that company.

The legislation applies to the South African resident that that holds the participation rights in the CFC (or the South African resident holding company that is required to include the results of the CFC in its consolidated financial statements under IFRS10). As Bob intends to own 100% of the shares in IOM, Bob would hold 100% of the participation rights in the CFC and the CFC legislation would apply to Bob.

In the case of Bob's intended arrangements, it is sufficient to note that a foreign company is a company that is not a South African tax resident company. A foreign incorporated company will be a tax resident of South Africa (per the section 1 definition) if it has its place of effective management in South Africa and it is not deemed to be exclusively resident of another country.

Bob must therefore be cautioned that if the IOM company is effectively managed from South Africa and is not deemed to be exclusively resident of another country, it would be a South African tax resident. As a South African tax resident, the IOM company would need to register as a taxpayer in South Africa and account for taxes on its global revenue as a South African taxpayer, i.e. all revenue it generates from the sale of ribbons.

Assuming Bob can demonstrate that the IOM company is tax resident outside of South Africa and is therefore a foreign tax resident company in which he will be the sole shareholder (holding all of the participation rights), Bob must consider the application of the CFC legislation to his intended ownership of IOM.

The CFC legislation prescribes that residents must include in their income (income being the amount remaining of gross income less exempt income) an amount calculated with reference to the "net income" of a CFC, unless an exemption applies. The amount to be included is based on the foreign tax year of the CFC that ends during the year of assessment of the resident, where the CFC has been a CFC for the entire year of assessment (refer section 9D (2)). In the case of a foreign company that has been a CFC for the entire tax year the inclusion amount is the proportional amount of the "net income" (which is explained below) determined for that foreign tax year, which bears to the total net income of that foreign company during that foreign tax year, the same ratio as the percentage of the participation rights of that resident in relation to that company bears to the total participation rights in relation to that foreign company on that last day. Special inclusion rules apply to companies that become CFCs or cease to be CFCs during the year.

The "net income" of a CFC is essentially the CFC's taxable income determined as if the CFC were a South African taxpayer. The legislation does not impose tax on the CFC. Rather the law seeks to impose tax on the South African resident shareholder of the CFC, which tax is calculated on a notional amount determined with reference to net income of the CFC in the proportion of such resident's participation rights to the total participation rights in the CFC. Bob as the sole shareholder of the IOM Company would need to apply the CFC rules in relation to his ownership of the IOM Company.

Further, there are no exemptions that would apply in this scenario to allow Bob to not include the net income of the IOM company in his income (refer below to question regarding the impact of creating substance for the IOM). Therefore, Bob's intended structural changes will not result in Bob paying less tax due to the application of the CFC rules.

Locating the IOM Company in a country with a double tax agreement with South Africa

A double tax agreement would act to restrict entirely or in part South Africa's right to impose tax on the income of a foreign party, in this case the CFC (i.e. IOM Company). The CFC provisions do not however seek to impose tax on the CFC or its income. Rather the CFC regime acts to include in the income of the resident shareholder a "notional

amount" described as the "net income" of the CFC, which notional amount happens to be calculated with regard to the receipts and accruals of the CFC. A DTA cannot therefore act to prevent taxation under the CFC regime.

Part 2

There are two primary exemptions that deem the net income of a CFC to be NIL, namely the high tax exemption (which is not relevant here) and the foreign business establishment exemption. The foreign business establishment (FBE) exemption applies as follows.

The net income of a CFC will be Nil where its receipts and accruals are attributable to any FBE of that CFC where the anti-diversionary income rules do not apply. A FBE is defined as a fixed place of business located in a country other than South Africa that is used or will continue to be used for the carrying on of the business of the CFC for a period of not less than one year, where:

- that business is conducted through one or more offices, shops, factories, warehouses or other structures;
- that fixed place of business is suitably staffed with on-site managerial and operational employees of that CFC who conduct the primary operations of that business;
- that fixed place of business is suitably equipped for conducting the primary operations of that business;
- that fixed place of business has suitable facilities for conducting the primary operations of that business; and
- that fixed place of business is located outside South Africa solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in South Africa.

Therefore, while the IOM company may not be able to place reliance on the high tax exemption, it should be tested to see if it is possible for the company to place reliance on the FBE exemption, having regard to the anti-diversionary income rules.

The anti-diversionary income rules state that an amount that is attributable to a FBE must still be taken into account when calculating the net income of a CFC, where that amount is derived from the sale of goods by the CFC directly or indirectly to a person, other than a connected person who is a resident, where the CFC initially purchased those goods or any tangible intermediary inputs thereof directly or indirectly from one or more connected persons who are residents, unless:

(aa) those goods or tangible intermediary inputs thereof purchased from connected persons who are residents amount to an insignificant portion of the total goods or tangible intermediary inputs of those goods;
(bb) the creation, extraction, production, assembly, repair, or improvement of goods undertaken by that CFC amount to more than minor assembly or adjustment, packaging, repackaging, and labelling;
(cc) the products are sold by the CFC to a person who is not a connected person in relation to the CFC, for physical delivery to a customer's premises situated within the country of tax residence of the CFC; or
(dd) products of the same or similar nature are sold by the CFC mainly to persons who are not connected persons for physical delivery to customers' premises situated within the country of tax residence of the CFC.

Bob being the 100% shareholder of the intended IOM CFC is a connected person in relation to the CFC. All sales of ribbons by Bob to IOM would therefore fall to be treated under this anti-diversionary income rule, as these sales are generated from the sale of products acquired from a connected person resident.

It is clear that IOM would not meet any of the above exceptions to the provisions of this anti-diversionary income rule. Therefore, the income generated by the IOM CFC from the sale of ribbons to South African and other African country customers, whether this income is attributable to a FBE in the IOM or not, must be considered for purposes of calculating the amount of net income to be included in the income of Bob.

Thus, the presence of substance (even sufficient substance to meet the FBE definition) will not prevent the application of the CFC rules, as explained above, and the income of the CFC will still be attributed to Bob, as the sole resident shareholder of the CFC.

Part 3

With regard to the question of transfer pricing, for the South African transfer pricing legislation to apply, a party to the transaction must derive a South African tax benefit. In this scenario, all of the income generated by IOM CFC would effectively be taxed in the hands of Bob, through the CFC legislation. Arguably, there is thus no South African tax benefit generated by any party to this transaction and therefore the transfer pricing legislation should not apply.

Part 4

With regard to VAT, the sale by Bob of the ribbons to the IOM company for on sale to South African customers would attract VAT at 15%. Sales to the IOM company may be zero- rated if they are to be directly exported by Bob (on

behalf of the IOM company) and delivered to customers of the IOM company outside of South Africa. In the case of South African sales, unless the IOM company registers as a VAT vendor and levies VAT on sales to South African customers, the 15% VAT levied by Bob on ribbon supplies to the IOM company for on sale to SA customers would cost the IOM company an extra 15%.

Question 2

The following is one approach that a candidate may take in answering this question.

Part 1

Applicable South African domestic law on dividends

Under section 9(2)(a) of the Income Tax Act, an amount is received by or accrues to a person from a source within the Republic if that amount constitutes a dividend received by or accrued to that person.

Under section 9(4)(a) of the Income Tax Act an amount is received by or accrues to a person from a source outside the Republic if that amount constitutes a foreign dividend received by or accrued to that person. Thus, if the company that paid the dividend is a South African resident company the dividend will be from a South African source. If it is paid by a “foreign company” (i.e. not a South African resident company") it will be from a source outside South Africa.

ALFA-BETA Ltd is a South African resident company and has distributed a dividend to its shareholders, ALFA Corporation and BETA Corporation. The dividends are therefore considered to be from a South African source.

Gross income in relation to a non-resident is defined as the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within South Africa, during such year or period of assessment, excluding receipts or accruals of a capital nature.

Paragraph (k) of the definition of ‘gross income’ in section 1 includes in gross income any amount received or accrued by way of dividends. However, section 10(1)(k)(i) exempts from normal tax “local dividends” (i.e. dividends that are distributed by South African resident companies).

However, besides the normal tax provisions, dividends are liable to dividend withholding tax. Section 64D defines a “dividend” to any dividend or foreign dividend as defined in s 1, including any amount contemplated in section 31(3)(i)(a), that is paid by a company that is a resident.

Dividends tax is a stand-alone tax (that is, it is not part of normal tax). It is levied under section 64E(1) at a rate of 20% on the amount of any dividend paid by any company other than a headquarter company.

Section 64G(1) states that: Subject to subsections (2) and (3), a company that declares and pays a dividend must withhold an amount of dividends tax from that payment calculated as contemplated in section 64E. The beneficial owner of the dividends is the one liable for paying the dividends tax. Section 64D defines a beneficial owner as meaning the person entitled to the benefit of the dividend attaching to a share.

There are however certain exemptions from Dividends tax. Those that could be applicable to the facts at hand as follows.

Under section 64G(3), a company may withhold a reduced rate of dividends tax from the payment of a dividend if the person to whom the payment is made has submitted to the company a written declaration by the beneficial owner that a dividend is subject to a reduced rate in terms of a DTA as well as a written undertaking to inform the company in writing should the beneficial owner cease to be the beneficial owner or the circumstances giving rise to the exemption change.

To determine if this exemption is applicable to the facts in this case, the DTA between South Africa and Country N has to be consulted.

Article 10(1) of the DTA provides that dividends paid by a company resident of a contacting state to a resident of the other contracting state may be taxed in that other state.

The source country tax limitations in Article 10(2) provide that recipient must be the beneficial owner of the dividend. With respect to the facts, it has to be determined if ALFA Corporation and BETA Corporation (the shareholders of ALFA-BETA Ltd) are indeed the beneficial owners of the dividends.

The term “beneficial ownership” is not explicitly defined in the DTA between SA and Country N. Article 3(2) of the SA/ Country N DTA, provides that where a term is not defined in the Convention, unless the context otherwise requires, a contracting state can make use of the meaning of the term under its laws that are used for the purposes of the taxes to which the Convention applies. As indicated above, section 64D defines a beneficial owner as meaning the person entitled to the benefit of the dividend attaching to a share.

This definition is in line with the OECD definition of the term, which can be helpful in clarifying “person entitled to the benefit of the dividend attaching to a share”. Paragraph 12 of the commentary on Article 10 provides inter alia that the term should not be used in a narrow technical sense; rather, it should be understood in its context and in light of the object and purpose of the convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

The OECD Model Commentary provides two guidelines for determining the meaning of the term.

- A nominee or agent who is a treaty country resident may not claim benefits, if the person who has all the economic interest in, and all the control over, property (the beneficial owner), is not also a resident. On the other hand, if the beneficial owner is a resident of the Contracting State, then treaty benefits are available even if the agent or nominee who holds title to the property and is legally entitled to collect the income from the property resides elsewhere.

- A conduit company cannot be regarded as a beneficial owner if, through the formal owner, it has as a practical matter, very narrow powers which render it in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties (such as the shareholders of the conduit company).

The OECD Commentary further explains that that beneficial owner as a “person who enjoys the real benefits of ownership, even though the title to the property is in another name. A resident of a tax treaty partner may be denied the benefits of certain reduced withholding tax rates if the beneficial owner of the dividends is resident of a third party.”

Students can discuss any international tax court cases on beneficial ownership such as:

- Hoge Raad, 6 April 1994, No. 28 638, BNB 1994/217
- Indofood International Finance Ltd v JP Morgan Chase Bank NA, London Branch [2006] EWCA CV 158
- Velcro Canada Inc v The Queen 2012 TCC 57
- Prevost Car Inc v Her Majesty the Queen 2008 TCC 231

The facts in this scenario show that the shareholders of ALFA corporation are Mr Duns and Mrs Smith, residents of Country U each holding 50% of the shares. ALFA Corporation has no business operations or employees in Country N. It has a shared office in Amsterdam that it uses three times a year to host the meetings of its board of directors. At one of the board meetings, it was resolved that that all income derived by ALFA Corporation from its businesses should immediately be paid over to the shareholders.

Based on these facts, it is probable that ALFA Corporation is not the beneficial owner of the dividend. It can be argued that ALFA Corporation is a conduit company that has an obligation to immediately transfer the dividends. The facts of this scenario can be distinguished from the facts in the Velcro Canada case where the court ruled that the entity in issue was the beneficial owner because it had full control and discretion over the dividends received and was not obligated to distribute dividends automatically to ultimate shareholders. The facts in this scenario show that the board resolved at that all income derived by ALFA Corporation from its businesses should immediately be paid over to the shareholders. Based on this distinction, it can be argued that ALFA Corporation did not have full control and discretion over the dividends received. The beneficial owners would therefore be Mr Duns and Mrs Smith, residents of Country U who each hold 50% of the shares of ALFA Corporation.

Based on this argument, ALFA Corporation does not qualify for the low treaty rate. South Africa can apply its domestic dividend withholding tax rate of 20%.

The answer to this question could go either way depending on the strength of the students’ arguments and analysis of the court cases relied on.

To relieve any double taxation that could arise, the residence state (Country N) may grant a tax credit to ALFA Corporation (according to Article 23) for taxes that equal to the withholding tax paid in South Africa.

In the case of BETA corporation, there are no indications from the facts that this company is a conduit company. The low withholding tax treaty rate in Article 10(2)(a) would apply.

As BETA Corporation holds more than 25% of ALFA-BETA Ltd.’s issued share capital, the 5% in terms of Article 10(2)(a) would apply.

Applicable South African domestic law on interest

Interest at a low rate was paid by ALFA-BETA Ltd to ALFA Corporation.

S24J deals with accrual and incurral of interest. In terms of s 24J(2), where any person is an issuer in relation to an instrument, such person shall be deemed to have incurred interest which must be deducted from income of that person derived from carrying on any trade if that amount is incurred in the production of income."
Thus, interest incurred by ALFA-BETA Ltd in the production of Income is deductible from income derived by ALFA-BETA Ltd in carrying on its trade.

Under Section 24J(1), ALFA-BETA Ltd is the issuer because it has an obligation to repay the amount of the loan extended by ALFA Corporation.

Under Section 24J(1) and Section 24J(3), ALFA Corporation is the holder of the instrument because it has extended an instrument in the form of interest-bearing debt to ALFA- BETA Ltd and is entitled to interest in terms of such instrument.

Since ALFA Corporation is a non-resident, it is taxed on a source basis in terms of the definition of "gross income" in s 1 of the ITA.

In terms of the source rules for interest, section 9(2)(b) states that an amount is received by or accrues to a person from a source within the Republic if that amount constitutes interest as defined in section 24J where that interest:

- is attributable to an amount incurred by a person that is a resident, unless the interest is attributable to a permanent establishment which is situated outside the Republic; or
- is received or accrues in respect of the utilisation or application in the Republic by any person of any funds or credit obtained in terms of any form of interest-bearing arrangement.

However, section 10(1)(h)(ii) exempts from tax, interest received by or accrued to a non-resident during any year of assessment, unless the debt from which the interest arises is effectively connected to a permanent establishment (PE) of that person in the Republic.

In terms of section 1 of the ITA, a PE has the same meaning as the term is defined from time to time in the OECD MTC. The relevant definition of a PE for these facts in relation to the power generating station, if the general definition is Article 5(1) – "a fixed place of business through which the business of an enterprise is wholly or partly carried out".

ALFA corporation qualifies for the section 10(1)(h) exemption as the debt from which the interest arises is not effectively connected to its permanent establishments in South Africa as the power station is owned by ALFA_BETA Ltd.

Besides the normal tax implications, the Income Tax Act also levies Interest withholding tax (sections 50A – 50H) at the rate of 15% on any interest which is paid to a non-resident to the extent that such interest is regarded as having been received or accrues from a source within South Africa.

However, section 50D(3)(b) provides that: "A foreign person is exempt from the withholding tax on interest if the debt claim in respect of which that interest is paid is effectively connected with a permanent establishment of that foreign person in the Republic if that foreign person is registered as a taxpayer in terms of Chapter 3 of the Tax Administration Act.

ALFA corporation DOES NOT qualify for the section 50D(3)(b) exemption as the debt from which the interest arises is not effectively connected to its permanent establishments in South Africa as the power station is owned by ALFA_BETA Ltd.

Since there is a DTA in place, a reduced treaty rate of tax may apply. In terms of section 50E(3)(a) the withholding tax on interest must be reduced if the foreign person to the payment is to be made has, before the interest is paid, submitted to the person making the payment a declaration that the interest is subject to that reduced rate of tax as a result of the application of an agreement for the avoidance of double taxation.

The circumstances in which the lower interest rate is applicable, in a context of a double tax treaty are as follows:

- Article 11(3) interest is defined as income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds, or debentures.
- Art 11(1) provides that "Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State." (resident state – Country N))
- Article 11(2): interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so

charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation."

The discussion above on beneficial ownership refers. Once again, the answer could go either way depending on the strength of student's arguments. In contrast to the decision reached in Prevost, where the taxpayer had a say in the distribution of the relevant amounts, it is probable that ALFA Corporation is not the beneficial owner of the interest. It could be ruled that it is a conduit company. The facts in this scenario show that the shareholders of ALFA corporation are Mr Duns and Mrs Smith, residents of Country U who each hold 50% of the shares. ALFA Corporation has no business operations or employees in Country N. It has a shared office in Amsterdam that it uses three times a year to host the meetings of its board of directors. In one of the board meetings it was resolved that all income derived by ALFA Corporation from its businesses should immediately be paid to the shareholders.

The facts of this scenario can be distinguished from the facts in the Velcro Canada case where the court ruled that the entity in issue was the beneficial owner because it had full control and discretion over the amounts received and was not obligated to distribute dividends automatically to ultimate shareholders. Based on the set of facts, the most probable argument is that ALFA Corporation is not the beneficial owner of the interest - it is a conduit company that has an obligation to immediately transfer the interest to the shareholders. The beneficial owners of the interest would be Mr Duns and Mrs Smith, residents of Country U each holding 50% of the shares of ALFA Corporation.

ALPFA Corporation would therefore not be entitled to the (10%) lower treaty rate. South Africa can apply its domestic tax rate.

The answer to this question could go either way depending on the strength of the students' arguments and analysis of the court cases relied on.

As indicated above, in terms of section 24J, ALFA-BETA Ltd is entitled to a deduction of interest incurred. Since ALFA Corporation granted a low interest loan to ALFA-BETA Ltd, South Africa may apply the transfer pricing provisions set out in section 31 of the ITA.

Section 31(2) provides that where any transaction, operation, scheme, agreement or understanding constitutes an affected transaction; and any term or condition there of results or will result in a tax benefit for a party to that transaction, the taxable income of that person must be calculated as if that transaction had been entered into in an arm's length dealing. In effect, SARS has the power to impose a primary adjustment to the terms and conditions of a transaction, operation, scheme, arrangement or understanding to reflect the terms and conditions that would have existed at arm's length.

In terms of section 31(3)(i), SARS can also impose a secondary adjustment. If the resident is a company, the difference between taxable income and the arm's length amount is deemed to be a dividend in specie (a dividend comprising a distribution of an asset) declared and paid by that resident to the non-resident. This implies that the resident company will be liable for dividends tax on the deemed dividend in specie at a rate of 20%.

The transfer pricing provisions are in line with Article 11(6) of the DTA which deals with special relationship/effective arm's length test.

The purpose of Art 11(6) is to restrict the operation of the treaty provisions concerning the taxation of interest in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest paid exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they contracted at arm's length. In such a case, the provisions of the Article apply only to that last mentioned amount and that the excess part of the interest shall remain taxable according to the laws of the two Contracting States, due regard being had to the other provisions of the Convention.

<u>Applicable domestic law relating to royalties</u>

Since ALFA Corporation is a non-resident, it is taxed on a source basis in terms of the definition of "gross income" in s 1 of the ITA. In terms of the source rules for royalties, in section 9(2)(d) of the income tax act, "An amount is received by or accrues to a person from a source within the Republic if that amount constitutes a royalty that is received or accrues in respect of the use or right of use of or permission to use in the Republic any intellectual property as defined in section 23I".

- Section 9(1) states that for the purposes of this section, "royalty" means any amount that is received or accrues in respect of the use, right of use or permission to use any intellectual property as defined in section 23I.
- Section 23I defines intellectual property as patent, design, trademark, copyright, property or right of a similar nature, knowledge connected to the use of such patent, design, trademark, copyright, property or right.
- A brand falls in the category of a "right of similar nature" and is therefore IP.

Under section 11(a) of the ITA, a person must, in determining the taxable income derived during the year of assessment from carrying on a trade, deduct expenditure and losses actually incurred in the production of income, provided that such expenditure and losses are not of a capital nature. Hence ALFA- BETA Ltd will be entitled to a deduction relating to the royalty expenditure.

Besides the above normal tax implications for royalties, section 49B of the ITA provides for levying a royalty withholding tax, on the amount of any royalty that is paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received by or accrued to that foreign person from a source within the Republic.

Section 49A of the Income Tax Act, also defines "royalty" to mean "any amount that is received or accrues in respect of— the use or right of use of or permission to use any intellectual property as defined in section 23I".
The foreign person could qualify for a reduced rate of tax in terms of a double tax treaty. In terms of section 49E(3)(a) the royalty withholding tax rate must be reduced if the foreign person to which the payment is to be made has, before the royalty is paid, submitted to the person making the payment a declaration that the royalty is subject to that reduced rate of tax as a result of the application of an agreement for the avoidance of double taxation.

The requirements for the lower DTA rate are as follows.

Art 12(2): "The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

Article 12(1) states that "royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State".

This means that the royalty paid by ALFA-BETA to ALFA Corporation shall only be taxable in Country N if ALFA Corporation is the beneficial owner.

The facts in this scenario show that the shareholders of ALFA corporation are Mr Duns and Mrs Smith, residents of Country U each holding 50% of the shares. ALFA Corporation has no business operations or employees in Country N. It has a shared office in Amsterdam that it uses three times a year to host the meetings of its board of directors. It was resolved in one of the board meetings that all income derived by ALFA Corporation from its businesses should immediately be paid over to the shareholders.

Based on the set of facts the most probable argument is that ALFA Corporation is not the beneficial owner of the royalty as it is a conduit company that has an obligation to immediately transfer the royalties to its shareholders. The beneficial owner would be Mr Duns and Mrs Smith, residents of Country U each holding 50% of the shares of ALFA Corporation. The answer to this question could go either way however; depending on the strength of the students' arguments and analysis of the court cases relied on.

Article 12(1) states that "royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State" (Country N).

Since ALFA corporation is not the beneficial owner, South Africa to levy tax on the royalties at the domestic rate.

Note that if the royalty payments are excessive South African apply its transfer pricing provisions in section 31 of the Income Tax Act (discussed above). These provisions are in line with Article 12(4) of the DTA which deals with excessive royalties and provides that the source country may tax the excess.

Part 2

BETA Corporation is a foreign company. Non-residents are in terms of section 1 of the Income Tax Act, taxed using the source basis of taxation.

Common law principles are used in South Africa to determine the source of rental income from immovable property. The source is where the immovable property is situated - COT v British United Shoe Machinery (SA) (Pty) Ltd 1964 FC.

Since there is a double tax treaty between South Africa and Country N, DTA provisions have to be referred.

Article 6 of the OECD MTC states "the term 'immovable property' shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the

provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources".

Art 6(1) states that "Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State" (source state). This Article deals with direct use of immovable property. Under Article 6(3), "The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property".

Rental payments derived from immovable property shall also be taxable in South Africa. If resident state taxes it has to provide relief under Art 23A and 23B.

Part 3

The facts show that BETA Corporation contributed its immovable property in consideration for a 30% shareholding in ALFA-BETA Ltd.

The immovable property contribution is regarded as a barter transaction in that the immovable property held by BETA Corporation is transferred to ALFA-BETA Ltd in consideration for shares issued by ALFA-BETA Ltd.

BETA Corporation is a foreign company. Non-residents are in terms of section 1 of the ITA, taxed using the source basis of taxation.

Section 9(2)(j) provides that "an amount is received by or accrues to a person from a source within the Republic if that amount constitutes an amount received or accrued in respect of the disposal of an asset that constitutes immovable property held by that person or any interest or right of whatever nature of that person to or in immovable property contemplated in paragraph 2 of the Eighth Schedule and that property is situated in the Republic".

In the case of MacDonald Ltd v Radin and the Potchefstroom Dairies 1915 AD 454, it was held that the term immovable things covers land and everything attached to the land.

In terms of paragraph 2(1) of the Eighth Schedule of the ITA, non-residents are subject to CGT in SA on their holdings in immovable property situated in SA or any interest or right of whatever nature to or in immovable property situated in the Republic.

BETA Corporation holds an asset in the form of immovable property situated in SA, so paragraph 2(1) applies.

As the property is held by BETA Corporation as a capital asset, the disposal of the property could have potential CGT implications if the proceeds arising upon disposal exceed the base cost of the property in BETA Corporations hands. Section 26A of the ITA read together with the Eighth schedule deals with the taxation of capital gains.

Under para 3 of the Eighth Schedule to the ITA, a capital gain arises if the proceeds received or accrued in respect of an asset disposed of exceed the base cost of that asset.

Paragraph 11 of the Eight Schedule defines a disposal to include any event, law which results in the, transfer of an asset. Given that following this transaction, the immovable property is transferred to ALFA-BETA Ltd, BETA Corporation can be said to have disposed of its property for tax purposes.

In the case of a non-resident, paragraph 3 can apply to immovable property hence it necessary to consider whether capital gain arises in the hands of BETA Corporation upon disposal of its immovable property.

The proceeds on the disposal of the Property by BETA Corporation would comprise the value of the shares in ALFA-BETA Ltd that BETA Corporations receives as consideration (Para 35 of the Eighth Schedule to the ITA).

The base cost on the disposal of the property by BETA Corporation is, generally speaking, the cost incurred by BETA Corporation in acquiring the property (Para 20 of the Eighth Schedule to the ITA).

If these proceeds exceed the base cost of the property, a capital gain would arise in BETA Corporations hands (Para 3 of the Eighth Schedule to the ITA).

Since there is a DTA in place, Article 6, 13 and 23 of the OECD MTC should be considered.

The term immovable property is defined in Article 6(2) the term 'immovable property' shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The article further provides that the meaning of the term includes land.

However, Article 6 applies to income derived from the direct use, letting, or use of immovable property. It does not cover income derived from the disposal of immovable property and so the income allocation rules in Article 6 are not applicable to the facts.

Article 13 which deals with income derived from the disposable of immovable property is applicable. The Article provides that "Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State" (source state where the property is situated).

Any gains derived by the immovable property contribution made by BETA Corporation to ALFA-BETA Ltd in consideration for shares issued by ALFA-BETA Ltd may be subject to Article 13.

The question requires a discussion of "the tax implications of the immovable property contribution made by BETA Corporation to ALFA-BETA Ltd". Students should also note that the use of the word "may" in Article 13(1), implies that tax sharing is allowed and the resident state of BETA Corporation (country N) may also tax the income derived from – if it does so, Article 23 OECD Model, has to be applied by Country N to eliminate of double taxation that may be incurred by BETA Corporation.

Since BETA Corporation contributed its immovable property in consideration for a 30% share in ALFA-BETA Ltd, the asset-for- share provisions in section 42 of the ITA should apply whereby CGT would not be levied provided the requirements of the section are met and the anti-avoidance provisions in section 42 are not triggered. Section 42 would apply to this type of transaction unless BETA Corporation and ALFA-BETA Ltd agreed in writing that it would not (section 42(8A)(a) of the ITA).

In terms of the definition in section 42(1)(a)(i)(aa), an "asset-for-share transaction" includes any transaction in terms of which a person disposes of an asset (other than an asset which constitutes a restraint of trade or personal goodwill), the market value of which is equal to or exceeds, in the case of an asset held as a capital asset, the base cost of that asset on the date of that disposal, to a company which is a resident, in exchange for the issue of an equity share in that company and that person at the close of the day on which that asset is disposed of, holds a qualifying interest in that company. A "qualifying interest", as defined, includes 10% of the equity shares and voting rights in a company

Assuming the market value of the immovable property contributed by BETA Corporation exceeds its base costs in BETA Corporation's hands at the time it is bartered for the shares in ALFA-BETA Ltd and given that BETA Corporation will acquire a qualifying interest (i.e. 30%) in the shares of ALFA-BETA Ltd following the transaction, the relevant requirements are met. Hence, section 42 of the ITA affords rollover relief under section 42(2)(b) in respect of any capital gain arising in BETA Corporation's hands. The capital assets, such assets are deemed to have been disposed of by the transferor at the transferor's base cost and the transferor and transferee are deemed to be one and the same person for purposes of determining the date of acquisition of the assets by the transferee; the amount and date of incurral of any expenditure in respect of the asset which was allowable in terms of paragraph 20 of the Eighth Schedule; and any valuation of the asset facilitated by the transferor (paragraph 29(4) of the Eighth Schedule).

Part 4

In terms of paragraph (b) of the definition of "asset" in Paragraph 1 of the Eighth Schedule to the Income Tax Act "an interest in immovable property" is considered an asset for Capital Gains Tax. Paragraph 2(2) of the Eighth Schedule to the Income Tax Act states that an interest in immovable property in South Africa may include equity shares held in a company or trust. A non-resident company may be subject to CGT in South Africa if they dispose of an interest in immovable property situated in South Africa when they hold shares in a company if 80% or more of the value of those shares is attributable directly or indirectly to immovable property held and if the non-resident company holds 20% or more of such shares.

Section 35A also provides for a withholding tax on disposal of immovable property by a non-resident:

- Section 35A(1) provides that (subject to sub-section (2)), where any person must "pay an amount" to any other person who is not a resident in respect of the disposal by that seller of any immovable property in the Republic, such purchaser must withhold form that amount the relevant portion of taxes due.
- Section 35A(1) makes no distinction between whether the asset is held on revenue account or not. Rather, the trigger for the section is the payment of an "amount" to a person who is not a resident;
- Immovable property means per the Eighth Schedule;
- 7.5% if the non-resident seller is an individual; 10% if the non-resident seller is a company and 15% if the non-resident seller is a trust.

ZICO Corporation would be required in terms of section 35A to withhold 10% of the payment it makes for the shares sold by ALFA and BETA Corporation and pay that over to SARS.

For DTAs that are based on either the OECD MTC or the UN MTC, Article 13(1) thereof provides that capital gains derived from the alienation of immovable property (as defined in Article 6) located in a country may be taxable in that state (source state). The residence state which retains the residual rights has to relieve the double taxation using the exemption or the credit method in terms of Article 23 of the MTC. Article 6(2) provides that the term 'immovable property' has the same meaning as under the law of the Contracting State in which the property is situated. From the above, it is clear that the treaty definition of term "immovable property" is based on the definition of the term in domestic law.

Article 13(4) sets out an anti-avoidance provision that deals with "offshore indirect transfers" of valuable underlying business assets, in particular "immovable property", situated in the other contracting state such that little or no CGT in levied on the realisation of asset in the country where it is located. Article 13(4) permit the source country to tax the capital gains derived from indirect offshore transfers.

Article 13(4) of the 2017 version of the OECD MTC provides that:

- Gains from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in a contracting state may be taxed in that state.
- The Article gives taxing rights over the profits associated with the sale of shares to the state in which the property is located if the majority (more than 50%) of the economic value of the shares arises from immovable property located in such state.
- The anti-avoidance provision can address cases where assets are contributed to an entity shortly before the sale of the shares in that entity so as to avoid capital gains tax in the contracting state where the immovable property situated. This is particularly so in situations where shares derive their value primarily from immovable property at any time during a 365 days period, preceding the alienation as opposed to at the time of the alienation only.
- In effect such gains can be taxed in the state where the property is located and not only in the state where the seller is resident.

If residence state taxes, credit for taxes paid in source state can be provided under Article 23.

With respect to the sale of shares by ALFA Corporation, since ALFA Corporation holds 70 per cent of the shares of ALFA-BETA -which exceeds the "50% per cent" threshold required by condition. Thus, South Africa shall have jurisdiction under Article 13(4) to tax such income without limitations.

In contrast, shares sold by BETA Corporation comply with condition in Article 13(4) in that BETA Corporation holds only 30 per cent of the shares of ALFA-BETA (i.e. less than the "50 per cent" threshold) as long as this percentage of shares has been maintained at any time during the 12-month period preceding such alienation (from the description of the Case Study it arises that from the beginning of the investment BETA Corporation has always maintained a 30 per cent participation in ALFA-BETA).

Where the value of the immovable property does not exceed 50 per cent of the aggregate value of all assets owned by ALFA-BETA, the sale of shares by BETA Corporation shall only be taxable in South Africa.

On the contrary, if the value of the immovable property exceeds such value, South Africa shall have jurisdiction to tax without limitation (e.g. may apply a withholding tax without restrictions on the applicable tax rate).

In cases where gains derived from the alienation of shares may also be taxed in Country N, it shall allow a credit or exemption in terms of Article 23B.

PART B

Question 3

Part A

South Africa (SA) operates a system of exchange controls, which require all capital remitted from South Africa to be processed through an Authorised Dealer (being a SA Bank that has been licensed by the Financial Surveillance Department of the South African Reserve Bank (Finsurv) to deal in foreign currency). Capital is widely defined and is considered to include cash and any other asset with monetary value. Exchange controls only apply to SA residents. As Martina is born and raised in South Africa, she would constitute an exchange control resident.

Martina being above the age of 18 and in possession of a valid South African identification document may make use of the following annual allowances to remit the R25million to her UK Broker's bank account.

Annual discretionary allowance R1million

Martina may approach her bank (being an authorised dealer) to request the transfer to her UK broker's account of the first R1million of her cash. There is no supporting documentation needed to make use of this allowance. Martina would agree a conversion rate to USD with her Authorised Dealer, and they would convert the R1million into her selected currency.

Annual foreign investment allowance R10million

Individuals 18 years or older are permitted to approach their authorised dealer to request permission to transfer offshore up to R10million annually, provided that they present to the Authorised Dealer a valid PIN that confirms their tax compliance Status with the South African Revenue Service (SARS). To obtain the PIN, Martina will need to undertake a process with SARS, whereby she will be subjected to a SARS audit and most importantly need to explain the source of the funds that will be remitted from South Africa. Provided the PIN is provided to the Authorised Dealer, the funds may be converted to foreign currency through the Authorised Dealer and remitted from South Africa.

Amounts exceeding the discretionary and foreign direct investment allowances

As Martina wishes to externalise more than the aggregate of the R1million discretionary allowance and the R10million foreign investment allowance, she would still need to follow the SARS compliance process and seek a PIN for presentation to her Authorised Dealer. However, the extent of SARS audit that she will be subject to will be more onerous. Further, once the compliance PIN is presented, the authorised dealer will need to make a submission to the Finsurv to request permission for Martina to remit from South Africa capital in excess of the annual allowances available to her as a South African exchange control resident individual.

The above is likely to be a process that would take approximately 6 months provided no defaults are identified by SARS.

Part B

A South African tax resident is defined in the case of an individual as, inter alia, anyone that is ordinarily resident in South Africa. A person is ordinarily resident when South Africa is the country to which they would naturally and as a matter of course return from their wanderings. It might therefore be called a person's usual or principal residence and it would be described more aptly, in comparison to other countries as the person's real home.

As Martina is born in South Africa, has lived here her entire life and has no intention of leaving South Africa, she is a South African tax resident. As a South African tax resident, Martina will be subject to income tax on her worldwide earnings. This means that all income (capital gains and dividends) that she generates from her foreign investments must be declared when she prepares her provisional tax calculations bi-annually and when she prepares her final provisional tax calculation (i.e. Top Up tax amount). The amounts should also be declared on her annual income tax return filing (IT12).

Martina will be taxed as follows on the income she will accrue from her investments:

Dividends from USA:

As these dividends accrue from foreign tax resident companies, they would be taxed as foreign dividends under South African tax law. As Martina holds less than 10% of the shares in the foreign company, she will qualify for partial tax exemption on these dividends (refer section 10B (3) of the ITA). The following formula will be applied to calculate the amount of the foreign dividend that is exempt from tax in South Africa:

A = B × C

“A” represents the amount to be exempted for a year of assessment in terms of this paragraph;

“B” represents where the person is a natural person the ratio of the number 25 to the number 45; and

“C” represents the aggregate of any foreign dividends received by or accrued to the person during a year of assessment that is not exempt from normal tax in terms of section 10B(2) (which exemption would not apply to Martina as she would not attain a 10% or more interest in the foreign companies she is investing into).

The effect of the formula is to deliver an effective tax rate of 20% for an individual on foreign dividends, where that individual is subject to tax at the highest marginal tax rate, being 45%.

The dividend must be converted to Rand in terms of section 25D of the ITA by applying the spot rate or average rate on the date of accrual, as individuals are permitted to elect either option.

By way of example, the foreign dividend is USD100, the exempt portion is 25/45 X 100 = 55.55. This means that 44.44 is taxable at 45%, which equals tax of 20 (i.e. an effective tax rate of 20% on the USD100). This amount must be converted to Rand at the spot rate or average rate, which is assumed to be R18 = 360.

Further, in terms of section 6quat, Martina may claim a credit for the withholding tax suffered in the USA. The law provides a concession whereby a full credit may be claimed, even though only part of the dividend is taxed (refer 6quat(1A) (proviso (ii)). In the above example, if the USD100 was subject to 15% withholding, then the calculation would be as follows:

Foreign dividend is still USD100, the exempt portion is still 25/45 X 100 = 55.55. 44.44 remains taxable at 45%, which equals tax of 20, however, Martina would obtain a full credit of the USD15 withholding tax paid, thereby reducing her South African tax bill to 5, and retaining an effective rate of 20% on the USD100. The USD5 would be converted at the spot rate of R18:USD1, being R90.

The extent of credit permitted must be calculated by applying the average exchange rate for the year of assessment. As this example aligns the average rate and the spot rate, it was not necessary to first convert the foreign dividend at the spot rate, then calculate the extent of credit at the average rate. However, where these two do not match it would be necessary where Martina elected to apply the spot rate.

<u>Capital gains</u>

Any capital gains, being the amount by which the proceeds (i.e. the amount realized from a sale of the shares) exceed the base cost of the shares (i.e. the cost to acquire the shares, plus any other amounts permitted to be added to the base cost per paragraph 20 of the Eighth Schedule to the ITA) will be included in the taxable income of Martina and subject to tax at her marginal tax rate.

Paragraph 43 of the Eighth Schedule dictates that the gain must be calculated in GBP where Martina acquired and sold the asset in GBP. The gain must then be converted to Rand by applying either the average exchange rate for that year of assessment or the spot rate on the sale of sale of the asset (specific rule for individuals).

As a private individual, Martina will qualify for an annual exclusion amount of R40,000 on her aggregate capital gain for the tax year. Furthermore, only 40% of the gain would be included in her taxable income. This will produce an effective tax rate of 18% on all amounts exceeding the R40,000 annual exclusion, where Martina is subject to tax at the highest marginal tax rate of 45%.

Again, by of example, if Martina realizes a capital gain of GBP100,000, she must convert that gain to Rand at the spot rate or average exchange rate for that year of assessment (depending on her election) . Applying the assumption that the spot or average exchange rate for the year is R22: GBP1, this amounts to a capital gain of R2,200,000. The first R40,000 is exempt from tax and 40% of the balance will be included in her taxable income. This equates to the following:

R2,200,000 - R40,000 = R2,160,000

40% of R2,160,000 is taxable = R864,000

Tax payable at 45% on R864,000 = 388,800 (just shy of an effective tare rate of 18% due to the effect of the R40,000 annual exclusion.

Question 4

Part 1

Tax consequences in South Africa: The subsidiary in SA is a separate legal entity taxable in SA according to the tax rules. If incorporated and tax resident in SA, its income would be taxable in SA on a worldwide basis.

If the subsidiary distributes dividends to its parent company, in terms of Article 10(1) of the treaty: “Dividends paid by a company which is a resident of a contracting state to a resident of the other contracting state may be taxed in the other state”. However, Article 10(2) provides that such dividends may be taxed in the contracting state of which the company paying the dividend is a resident and according to the laws of that state, but if the beneficial owner of the dividends is a resident of the other contracting state, the tax so charged shall not exceed:

- 5% of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends;
- 15 % of the gross amount of the dividend in all other cases.

As Pharmaco Corporation holds all the shares in the subsidiary, South Africa would only have the right to tax 5% of the gross amount of dividends the subsidiary distributes to Pharmaco Corporation under South Africa’s Dividends Tax rules.

Part 2

A branch constitutes a PE in terms of art 5(1): a fixed place of business through which the business of the enterprise is carried on.

Art 7(1) deals with the taxation of the profits of a PE. It provides that the business profits of an enterprise of one state (Country A) cannot be subjected to tax in the other state (SA) unless that enterprise carries on a business in the other state through a permanent establishment established in that other state.

If the enterprise does carry on a trade or business in this way, the state in which the permanent establishment is situated (SA) may tax only those profits which are attributable to the permanent establishment (Art 7(1)).

- The branch would only be subject to tax in SA on a source basis (as it is regarded as an extension of the non-resident company Pharmaco.
- Internal charges between the branch and the head office would be mostly denied as a deduction.
- Some notional charges may be permitted under Article 7(3) the treaty. In that case transfer pricing principles would apply to such charges.
- The branch would not be permitted to claim credit/deduction for foreign taxes paid.
- No withholding taxes would apply to payments by the branch to its head office (i.e. no branch remittance tax)

Part 3

Does Mr Jones’ work in SA creates a PE for Pharmaco in SA?

- Art 5(7) a subsidiary per se does not create a PE of its parent company.
- But in terms of art 5(1) if space been created in subsidiary for an employee of the parent co, to do its work or oversee its work, the space at its disposal in the subsidiary constitutes a PE of the parent co in the subsidiary’s office.
- Students should discuss the South African case of AB LLC and BD Holdings Tax Court Case Number 13276 May 2015.
- Is the duration requirement met? He was in SA for 7 months

Paragraph 19 of the 2017 OECD Model Commentary on Article 5 provides for a PE requirement is 6 months – PE created.

Pharmaco Corporation liable to tax on profits attributable to PE created in SA due to space availed for Mr Jones in SUBCO for 7 months to ensure that the SUBCO complies with its obligations under its contracts concluded with the Pharmaco Corporation. I.e. the Business of Pharmaco is carried out through the PE of Pharmaco.

The service income Mr Jones receives:

- He works in SA for 7 months – liable to tax in SA on source basis on his service income under SA domestic law because his services were rendered in SA.

- Art 15 of the treaty between Country A and SA applies – deals with income from "Dependent Personal Services".
- Art 15(1) attributes exclusive taxing right to recipient's resident state unless employment is exercised in the source state. In terms of Article 15(2), if employment is excised in the Other Contracting state, the Other Contracting State (i.e. state of source) has right to tax as well if:

  - recipient of income is present in Source State for more than 183 days in any twelve month period; or
  - remuneration is paid by, or on behalf of, an employer who is a resident in the state of state of source, or
  - remuneration is deductible in determining the profits of a PE or fixed based which the employer has in the State of source.

- Was Mr Jones in SA for more than 183 days? Yes.
- Was employer in SA? No
- Was remuneration deductible in determining profits of a PE that employee had in SA? No.

  - So, SA has right to tax in terms of the treaty
  - As a resident of Country A – he is also liable to tax in Country A on a worldwide basis.
  - He would be subject to double taxation (conflict of source/residence bases of taxation).
  - Relief of taxation: Art 23A & B OECD MTC, resident state to use either exempt or credit method to relieve tax levied in source state

Part 4

Does Peter's work in South Africa create a PE for Pharmaco Corporation in SA?

- He is an independent consultant (discuss difference between art 5(5) dependent agent and art 5(7) by which independent agents are excluded from PE status
- Note: If students discussed the question based on the OECD MTC, then Peter's income as an Independent Consultant falls under Article 7 and 5.
- Is the PE time threshold met? (6 months) (he was in SA for 7 months)
- If students actually referred to the treaty itself, the treaty contains Article 14 which is based on the UN Model. Article 14 (independent personal services) applies if there is a fixed base regularly available to him in the source state. A fixed base is deemed to exist if the individual was in the other state for more than 183 days. In terms of paragraph 4 of the 1977 OECD Commentary on article 14, the term fixed base includes an office.
- Peter spends 7 months working in South Africa in the offices of SUBCO.

  - The office is a fixed base so that Article applies.
  - Note that Article 14 was deleted from the OECD MTC and independent personal services are deal which under Article 7 and 5 (PE rules).
  - Either way, whether students relied on Article 7 OECD MTC or Article 14 based on UN MTC, the attribution rules in Article 7 will apply.
  - Peter's profits attributable to work done in South Africa are taxable in South Africa on a source basis. Note that in terms of Article 3(1)(c) – the definition of an "enterprise" Peter could also be considered as the carrying on of business, whereby business which creates a PE for him in South Africa. Article 3(1)(h) states that "the term "business" includes the performance of professional services and of other activities of an independent character".

- As a Country A resident Peter is also liable to tax on his worldwide income.
- Peter would therefore be subject to double taxation (conflict of source/residence bases of taxation.
- Relief of taxation: Art 23A & B OECD MTC, resident state use either exempt or credit method to relieve tax levied in source state:

  - The income he earns is not employment income – he is not employed by Pharmaco corp. He is a consultant – he earns consultancy fees.
  - As an Country A resident he is entitled to relief of double taxation using the credit method – Article 23(1)

PART C

Question 5

Part 1

It would be reasonable to assume that the foreign companies will not be South African tax residents, as the local joint venture partners will hold the majority interest in the companies and control and operate these companies from their home jurisdictions. Hence, they would be incorporated outside South Africa and would be effectively managed from outside South Africa and thus would not be considered South African tax residents under the South African tax law definition of residence.

A CFC is defined as a foreign company where South African residents own more than 50% of the voting or participation rights; or a foreign company where the financial results are reflected in the consolidated financial statements of a South African tax resident company under IFRS10 other than a headquarter company, as defined. In the case of a foreign company that issues shares that are similar in character to South African ordinary shares, a participation right is defined as the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share in the foreign company. The foreign subsidiaries will not be CFCs, as Janet will be issued shares that are equivalent to SA Ordinary shares and as the only South African shareholder in each of these companies, will not hold more than 50% of the ordinary shares in the foreign companies.

Part 2

Section 31 of the ITA contains the transfer pricing rules. These rules apply to any affected transaction that contains any term or condition that is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length and results in a tax benefit for one of the parties to that affected transaction. A tax benefit is defined to include any avoidance, postponement, or reduction of any liability for South African tax.

An affected transaction includes a transaction between a resident (being Janet) and a non-resident (being her Kenyan and Nigerian entities) that are connected persons. A company is regarded as being connected to any other person, other than a company as defined in section 1 of the Companies Act, that alone or together with any connected person, holds directly or indirectly at least 20% of the equity shares or voting rights in the company. Equity share is defined to mean any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution. By way of example, South African ordinary shares would be equity shares as typically ordinary shares are not constrained in terms of their right to participate in the profits of the company in line with the ownership percentage of the shareholder. As Janet would own 45% of the ordinary shares in the Kenyan and Nigerian companies, she would be a connected person in relation to these companies (refer section 1, connected party definition for companies, sub (iv) of the ITA).

The sale by Janet of the paper clips at cost to her connected persons in Kenya and Nigeria gives rise to a tax benefit for Janet in South Africa, as Janet would not generate taxable income from these sales. Further, any dividends generated by Janet from these subsidiaries would be tax exempt under South African tax law, as the provisions of section 10B(2)(a) would apply. Section 10B(2)(a) exempts from income tax foreign dividends that accrue to Janet where she holds at least 10% of the total equity shares and voting rights in the company declaring the foreign dividend, the dividend is not deductible under the tax laws of the country of the company distributing the dividend and the foreign dividend is received on equity shares.

Furthermore, it is unlikely that Janet would be willing to supply paper clips at cost to an independent third party. Granted she may be willing to provide some level of wholesaler discount, but cost would not be appropriate, which demonstrates an absence of commercial terms that would be agreed between independent persons.

Therefore, if Janet were to implement her proposed export pricing model, she is at risk of being subject to transfer pricing adjustments under section 31 of the ITA.

In terms of section 31(3), Janet would be subject to a primary adjustment, whereby her taxable income would be increased by the amount of margin she should have generated on the paper clips sold to Kenya and Nigeria.

Furthermore, the amount adjusted under 31(3) will be deemed a donation made by Janet subject to donations tax. To mitigate against such an outcome the following action is recommended:

- Janet should engage a third-party service provider to perform a transfer pricing study to help her establish an appropriate price at which to sell the paper clips to the companies in Kenya and Nigeria.
- The study should include a function and risk analysis which examines all the functions and risks that the Kenyan and Nigerian entities will be undertaking an assuming.

- Having regard to the price at which the paper clips can be sold in the local markets, a price should be set between Janet and the foreign subsidiaries which will allow her to generate an acceptable profit margin on the clips supplied and the in-country subsidiaries to generate sufficient profit margin to satisfy not just the local tax authorities but her joint venture partners and majority shareholders. Factors that would impact the profit to be generated by Janet would include items such as the exclusive nature of the agreement, volumes to be supplied, the risk Janet is required to assume in relation to the products themselves and the logistics of exporting these products to these territories.

<u>Question 6</u>

The tax treatment of distributions by trustees of a foreign trust are taxed per section 25B of the ITA and Paragraph 80 of the Eighth Schedule to the ITA. The former governs the treatment of income receipts and accruals while the latter governs the treatment of capital receipts and accruals.

<u>Part 1</u>

Where trustees vest foreign dividends in the hands of an individual in the year in which the foreign dividends accrue to the trust, the following tax treatment will apply.

In the scenario where the Trust holds the portfolio of shares directly (and not through a 100% owned foreign company), the dividend will fall to be treated in terms of section 25B of the ITA. The individual will therefore be taxed on the foreign dividend income as if the foreign dividend had accrued directly to that individual.

The tax treatment of foreign dividends is regulated per section 10B of the ITA. Section 10B allows for either a full or a partial exemption on foreign dividends. To qualify for the full exemption the individual must hold directly at least 10% of the shares in the foreign company that distributed the dividend. In the scenario, regardless of the ownership percentage held by the trust in the foreign company, the dividend could not qualify for full exemption as the individual beneficiary is not the direct owner of the shares.

The individual may however qualify for partial exemption. Section 10B (3) of the ITA contains a formula that allows a taxpayer to calculate the extent of foreign dividend that would qualify for exemption depending on the marginal rate at which the South African resident individual is taxed. This formula does not require the taxpayer to own directly the shares in the company that distributed the foreign dividend.

Therefore, the South African resident individual beneficiary should qualify for the partial exemption and be subject to income tax on the foreign dividends at a maximum effective tax rate of 20% on the foreign dividend.

Assuming the foreign dividends are paid in foreign currency, the South African resident individual should refer to section 25D of the ITA to calculate the amount to be included in their income for purposes of calculating the tax. Section 25D allows individual taxpayers to elect to apply either the average exchange rate for the year of assessment or the spot rate on the date of accrual to calculate the amount of ZAR to be included in their gross income.

In the case of a capital gain that is realized by the foreign trust from the sale of the shares and vested in the hands of the South African tax resident beneficiary in the same year of assessment in which that gain arose, the provisions of paragraph 80(2A) of the Eighth Scheduled to ITA govern the tax treatment of the vested amount in the hands of the individual beneficiary.

The law, as it currently stands, gives rise to some uncertainty. The reason being that the legislator seemingly intended to align the tax treatment of foreign capital gains with the tax treatment of foreign dividends, whereby no full exemption can be achieved where the gain is vested in the same year in which it accrues to the trust. However, arguably, the law allows a taxpayer to assess whether the foreign trust would have determined a capital gain in that year of assessment had it been South African tax resident, even when applying the law to the case where the trustees vest the gain in the same year in which the gain accrues to the trust. If the foreign trust would have realised a gain, the amount constituting a capital gain that would have been determined, must be taken into account as a capital gain for the purposes of calculating the aggregate capital gain or aggregate capital loss of the individual beneficiary.

When applying the hypothesis to the foreign trust, it is necessary to assess if any exemption would have applied to the trust on the disposal of the shares giving rise to the gain. Specifically, paragraph 64B states that a person must disregard a capital gain (or loss) determined on the disposal of shares in any foreign company for market value, if that person, immediately before that disposal, held an interest of at least 10% in the equity shares and voting rights of the foreign company; for a period of at least 18 months; and the shares were disposed of to a non-resident (that is not a controlled foreign company (under SA law) or a related party or a company with substantially the same shareholders as the seller).

The exclusion to the application of paragraph 64B under Paragraph 80(4) omits a reference to paragraph 80(2A). Therefore, where the law is applied to determine whether the amount vested by the foreign trust would have constituted a capital gain in the foreign trust had it been a South African tax resident and this provision (i.e. paragraph 64B exemption) would have allowed the capital gain to be disregarded, the beneficiary would also be entitled to disregard the gain, regardless of the trust's ownership arrangements in the company giving rise to the gain.

However, where the trust would not qualify for a paragraph 64B exemption were it South African resident, neither would the beneficiary. This approach of allowing an exemption for the South African resident in these circumstances does not align with the approach applied by National Treasury to foreign dividends that are vested in the same year

in which they accrue to the trust. The current language is arguably an oversight and does not correctly represent the intention of the legislator. This is evidence by the most recent draft legislation released for comment by 31 August 2024 (the Draft Taxation Laws Amendment Bill), which includes amendments to paragraph 80(4) that will have the effect of causing the gain to be taxed where it is vested in the same year of assessment that it accrues to the trust.

Part 2

In the case of trust capital that was created through the accrual of foreign dividends, per section 25B((2A), it is necessary to tax the income in the hands of the beneficiary based on a hypothetical scenario applied to the foreign trust. In this regard, if the capital distributions are made out of amounts that would have constituted income in the hands of the foreign trust in the year those amounts accrued or were received by the foreign trust had the foreign trust been a South African tax resident, then the capital distributions should be taxed as income in the hands of the South African resident beneficiary. Therefore, in the case where the foreign trust owns the share portfolio directly and has an interest of between 10%-50% in the foreign company, the foreign trust may have qualified for 10B (2) exemption, which would allow the individual to also treat the foreign dividend as exempt. However, where the foreign trust owns more than 50% of the shares in the foreign company, it is precluded from applying the 10B (2) exemption and the individual would need to apply the partial exemption.

In the case of a capital gain that is retained in the trust and vested in a subsequent year, the tax treatment as described above, taking into the account the limitations imposed on the ability to apply the paragraph 64B exemption (per paragraph 80(4)) would apply i.e. if the capital distributions are made out of amounts that would have constituted capital gains in the hands of the foreign trust in the year those amounts were derived by the foreign trust had the foreign trust been a South African tax resident, then the capital distributions should be taxed as capital gains in the hands of the South African resident beneficiary. Therefore, in the case where the foreign trust owns the share portfolio directly and has an interest of between 10%-50% in the foreign company (together with connected persons), and the foreign trust would have qualified for section 64B exemption upon disposal of those shares, the section 64B exemption would also apply to the taxation of the amounts treated as capital gains in the hands of the individual beneficiaries.

Part 3

Where the foreign trust elects to hold the portfolio of assets through a foreign company, and that foreign company distributes a foreign dividend to the trust, and the trustees vest the foreign dividend in the hands of the resident individuals in the same year in which the dividend accrues to the trust, the tax treatment as described above would applies. The dividend would therefore be partially exempt.

In the cases where the shares are held by the trust through a 100% owned foreign company and the dividends are not distributed in the same tax year by the trust as they are received or accrued from the foreign company, they would be treated as foreign dividend income in the hands of the beneficiary but the beneficiaries would not gain the benefit of the participation exemption because the trust holds more than 50% of the shares in the foreign company and the exclusion set out in section 25B(2A) of the ITA applies.

Therefore, in the case where the foreign trust holds the share portfolio through a wholly owned subsidiary and the foreign dividend is generated from the wholly owned subsidiary, the individual could only seek to apply the partial exemption.

In the case where shares are held by the trust through a 100% owned foreign company and the shares in the 100% held company are sold and the gain arising from that sale is vested in the hands of the beneficiary in the same year of assessment, the law as described above would apply. In other words, once the proposed changes to the law are enacted, the gain would be taxable in the hands of the beneficiary, as you may not apply the paragraph 64B hypothesis to the trust (as the trust owns more than 50% of the foreign company).

In the cases where the shares are held by the trust through a 100% owned foreign company and the gain derived by the foreign trust is not distributed in the same tax year by the trust as it is derived by the foreign trust the distributed gains would be treated as capital gains in the hands of the beneficiary but the beneficiaries would not gain the benefit of the para 64B participation exemption because the trust holds more than 50% of the shares in the foreign company and the exclusion set out in para 80(4) of the Eighth Schedule to the ITA will apply. The gain would be taxed in the hands of the individual beneficiary at their applicable marginal rate.

Question 7

Part 1

Article 1 of the MLI, provides that the convention shall modify Covered Tax Agreements (CTAs) i.e. existing double tax treaties, which are concluded between parties to the MLI and for which both parties have made a notification that they wish to modify the agreement using the MLI.

Countries can choose which provisions of the MLI they would not like to apply to their CTAs. This is done by making certain reservations which imply that the country may opt out completely or partially of certain provisions with respect to all or some of its CTAs. Where a provision of the MLI applies, it will override the provisions of a pre-existing CTA to the extent that they are incompatible.

Article 4 of the MLI deals with dual resident entities other than individuals: Article 4(1) of the MLI embodies the recommendation in Action 2 of the BEPS Project, to the effect that the POEM "tie-breaker" test is replaced with the requirement that the competent authorities of the two contracting states have to reach a mutual agreement on the country of residence of the entity, having regard not only to the POEM, but also the place where it is incorporated, or any other relevant factor. If the competent authorities fail to agree, the taxpayer shall lose entitlement to tax relief, except as may be agreed by the competent authorities.

Both South Africa and Mauritius have ratified the MLI. While South Africa opted in for the provision relating to dual resident entities, Mauritius opted out. Therefore, this provision in the MLI shall not apply when addressing dual resident entities in respect of the double tax treaty between South Africa and Mauritius (the DTA). The parties will have to resort to the DTA.

Article 4(3) of the renegotiated treaty which was published on 17 July 2015 – states that:

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavour to settle the question and determine the mode of application of the Agreement to such person. In the absence of such agreement such person shall be considered to be outside the scope of the Agreement except for the provisions of Article 25.

Essentially the Article dealing with dual residence of entities in the existing DTA gives the same effect as that in the MLI.

Part 2

In a double tax treaty context, Article 27 of the OECD Model Tax Convention is one of the instruments that countries can employ to collect taxes beyond their borders with the assistance of their treaty partners. Article 27(1) of the DTA states that Contracting States shall lend assistance to each other in the collection of "revenue claims" which are defined in Article 27(2) to mean an amount owed in respect of taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to this Agreement or any other instrument to which the Contracting States are parties. This includes cases of tax evasion. The term "revenue claim" also applies to the interest, administrative penalties and costs of collection or conservancy that are related to such amount" (Paragraph 12 of the Commentary on Article 27(2) of the OECD Model. Article 27(1) of the DTA provides that the competent authorities of the contracting states may by mutual agreement settle the mode of application of this Article.

In terms of Article 2(3) of the DTA a revenue claim of a Contracting State shall at the request of the competent authority of that State be accepted for collection in the other State if it is enforceable under the laws of that former State and the person owing the amount has no administrative or judicial rights to prevent such collection (Paragraph 15 of the Commentary on Article 27(3) of the OECD Mode). Article 27(4) of the DTA safeguards the collection rights of a Contracting state, by enabling it to request the other state to take measures of conservancy regarding a revenue claim even where it cannot yet ask for assistance in the collection of taxes. This is the case when for instance the revenue claim is not yet enforceable or when the debtor still has the right to prevent its collection (Paragraph 19 of the Commentary on Article 27(4) of the OECD Model). An example of a measure of conservancy to which Article 27(4) refers is the seizure or the freezing of assets before final judgment so as to guarantee that these assets will still be available when collection subsequently takes place.

Part 3

This is a "tax sparing provision".

In order to encourage foreign investment, developing countries often grant fiscal incentives to foreign investors. These incentives are usually in the form of special tax provisions, such as tax holidays, credits, deductions or

exemptions, granted to qualified investment projects that are not applicable to investment projects in general. It is argued that when countries sign a double tax treaty, and an investor from one of the counties (usually a developed country) is offered a tax incentive by the other country (usually a developing nation), the tax incentive may be eliminated or reduced by the tax regime of the investor's residence country through corresponding tax increases.

An investor whose home country applies the residence basis of taxation and the credit method to relieve double taxation, may find that a tax reduction offered as an investment incentive by host country, may be offset by higher home-country taxes.

This is because under the ordinary tax credit method a deduction for home country taxes is allowed only for the tax actually paid in the host state.

If the actual foreign tax paid is lower than the domestic tax liability on the same income, the investor must pay the difference as additional tax in the home country. Thus, any tax saving incentive granted in the host country would be recaptured by the home country.

Under these circumstances, there appears to be no point for host countries to offer tax incentives to foreign investors, since that benefit does not accrue to the investor but to the investor's country of residence.

It is thus argued that, if a developing country uses its public funds to provide a tax incentive that would promote economic growth, it is unfair, for a developed country to recoup this incentive through higher taxes imposed on its residents that invest in the developing country.

Such a system effectively transfers resources from the treasury of the developing country to the treasury of the developed country and thus nullifies the sovereign right of developing countries to adopt industrial policies.

To prevent this consequence, some states usually include "tax sparing" provisions in their tax treaties whereby, the investor's home country grants the investor relief from taxation of host/source country taxes that have not actually been paid due its tax incentive programme.

In effect, the tax sparing provisions preserve the tax incentive granted by developing country by requiring the developed country to give a tax credit for the taxes that would have been paid to the developing country if the incentive had not been granted.

This hypothetical or notional credit for foreign taxes paid to the host state, allows the investor to retain the tax waived (spared) by the host country. Thus any special tax incentive offered by the host country enhances the after-tax profitability of foreign investors and are not simply offset by higher taxes in his country of residence.

Although tax-sparing is usually granted by developed countries to developing countries, sometimes the signatories agree to reciprocal sparing concessions. Usually, tax sparing provisions apply to reductions in taxes on business profits, and often also to reductions in withholding taxes on dividends, interest or royalties, granted under specific incentive legislation.

Question 8

The issue is whether Mr Smith qualifies as a South African tax resident.

In terms of section 1 of South Africa's Income Tax Act, residents are taxed on a residence (worldwide) basis. Non-residents are taxed on income derived from a South African source.

In terms of the definition of "resident" in section 1 of ITA, a natural person is resident in South African if the person is "ordinarily resident" in South Africa or if he is not so ordinarily resident, the person meets the requirements of the 'physical presence' test provided that the person is not exclusively a resident of another jurisdiction in terms of a DTA concluded between South Africa and that jurisdiction.

It has to be considered if Mr Smith is tax resident in South Africa under these tests.

Ordinary residence test

The phrase "ordinary residence" is not defined in the ITA. Consequently, case law has to be considered on to determine its parameters. Students are expected to discuss cases such as:

- In Levene v IRC 1928 AC, it was held that the term "ordinary residence" denotes residence in a place with some degree of continuity, apart from accidental or temporary absences.
- In Cohen v CIR 1946 AD 174, the court proposed in an obiter dictum that a person's ordinary residence would be the country to which he would naturally and as a matter of course return from his wanderings. This would be the country a taxpayer might call his usual or principal residence and would be described ... as his real home.
- In CIR v Kuttel 54 SATC 298, the court acknowledged that, even though the taxpayer was still substantially connected to South Africa through business activities, visits and the retention of a house in Cape Town, his activities and mode of life in the USA (he rented a house, his family lived and worked with him, he joined a church, opened banking accounts, acquired an office, bought a car and registered with social security) and the purpose of his remaining connections with South Africa (his initial visits were primarily business orientated and the Cape Town house was retained for financial and exchange control reasons and not to retain a home), indicated that his real home' was in fact not in South Africa, but in the USA.
- In the Canadian case of Thompson v Minister of National Revenue, 2 DTC 812 (SCC) it was held that a person is ordinarily resident in the place "where in the settled routine of his life; he regularly, normally or customarily lives or at which he, in mind and in fact, settles into or maintains or centralises his ordinary mode of living with its accessories in social relations, interest and conveniences".

It is important to note that the ordinarily resident test in the definition of resident applies regardless of how many days in the tax year the person is in the Republic. In other words ordinary residence is not determined by physical presence. It is in effect a state of mind. A person who is ordinarily resident in South Africa in terms of the principles set out above is a resident as defined even though he may not be in the Republic for the required number of days.
Students are also expected to refer to "SARS Interpretation Note 3 (Issue 2) - Resident: Definition In Relation To a Natural Person – Ordinarily Resident" (20 June 2018), which states the following two requirements need to be present for a person to be "ordinarily resident" in South Africa:

- an intention to become ordinarily resident in a country; and
- steps indicative of this intention having been or being carried out.

Interpretation Note 3 further provides that SARS considers the following factors in determining the above two requirements but that the list is not intended to be exhaustive or specific, merely a guideline:

- most fixed and settled place of residence;
- habitual abode, i.e. present habits and mode of life;
- place of business and personal interest;
- status of individual in country, i.e. immigrant, work permit periods and conditions;
- location of personal belongings;
- nationality;
- family and social relations (involvement in schools, church, etc.);
- political, cultural or other activities;
- application for permanent residence;
- period abroad; purpose and nature of visits;
- frequency of and reasons (for) visits.

From the facts, the court cases and Interpretation Note 3, it can be concluded that Mr Smith is not ordinarily resident in South Africa. Although students may argue this both ways, it would seem that the bulk of the facts suggest that Mr Smith has fewer ties with South Africa than those with other jurisdictions.

Physical presence test

In terms of the definition of "resident" in section 1 of the Income Tax Act, a natural person who is not ordinarily resident in South Africa can become a resident if they are physically present in South Africa for a period or periods:

- exceeding 91 days in aggregate during the current year of assessment and
- exceeding 91 days in aggregate during each of the five years of assessment preceding the current year of assessment and
- exceeding 915 days in aggregate during the five years of assessment preceding the current year of assessment.

The 91 day and 915 day periods of physical presence in the Republic need not be continuous. If a person is present for several intermittent periods, which in aggregate exceed 91 or 915 days in the preceding five years of assessment, residence will be established. Students may also refer to "SARS Interpretation 4 (Issue 5) - Resident: Definition In Relation to a Natural Person – Physical Presence Test" (3 August 2018).

From the facts it can be concluded that Mr Smith is a qualifies as a resident of under the physical presence test. Mr Smith spends 185 days in South Africa and has done this for the past 10 years.

It can be concluded that Mr Smith is dual resident. He is tax resident in Country U under its domestic law by reasons of his birth in that country and he is tax resident in South Africa by virtue of the physical presence test.

The application of the residence basis of taxation is subject to the various double tax agreements a country has with other countries.

Double tax treaty provisions

There is a double tax treaty in place. Tax treaties provide a separate set of rules for determining whether a person is a resident of a country. In terms of article 4(1) of the OECD Model Tax Convention, a person is a resident of a state if liable to tax in that state for tax by reason of domicile, residence, place of management, or similar criteria.

When the two states treat the same person as "a resident" for tax purposes under their domestic law, that person is said to be 'dual resident' and thus fully liable to tax in both states.

In order to alleviate the ensuing double taxation, the OECD MTC has tie-breaker rules which allocate the residence of the "dual resident" person to one of those states so that the person is treated as a resident solely of that state for the purposes of the treaty.

Article 4(2) of the OECD MTC sets out the tie-breaker rules for individuals. If an individual is a resident of both Contracting States, then he shall be deemed to be a resident only of the state in which he has a permanent home available to him; if he has a permanent home available to him in both states, he shall be deemed to be a resident only of the state with which his personal and economic relations are closer (centre of vital interests).

A permanent home is one arranged and retained for permanent use and not merely for stays of short duration.

Centre of vital interests is a question of fact that takes into account family and social relations, occupation, political and other activities, place of business, etc. If the state in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either state, he shall be deemed to be a resident only of the state in which he has an habitual abode;

Habitual aboard is the state in which he stays more frequently over a reasonable period.

If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national.

If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Students are expected to work through each of these elements step by step, by testing the facts on each step to determine which determine at which step the tie will be broken.

The answer could go either way depending on student's arguments. Although the facts seem to lean toward the tie (and residence) being broken at the level of nationality (Mr Smith is a citizen of country U) some students may argue that his wife is in South Africa, which may swing the residence to South Africa. Students are expected to discuss relevant case law. For example, the following:

<u>Shepherd v Revenue and Customs Commissioners [2006] STC 1821.</u>

Mr Shepherd, a pilot, who was ordinarily resident in the UK decided to move his residence to Cyprus when retired. The reason for the move was to ensure that his pension from British Airways would be subject to tax in Cyprus at lower rates. The court took into account relevant factors which played a role like the fact that he had acquired a flat in Larnaca in 1998, he joined the Cyprus Offshore Yacht Club and the Crusader Gliding Club, he retained his membership of the British Hang Gliding Club, the Royal Yachting association and the British Airways Yacht Club, he had a house in the UK which he had inhabited with his legal wife and he had a joint bank account with his wife and a high interest savings account in his own name at a bank in the UK.

Mr Shepherd argued that even though he continued to visit the UK, Cyprus was where he had his base. He was only in the UK for temporary purposes and not with the intention of maintaining his residence there.

UK Revenue argued that all the relevant factors pointed to the conclusion that there had been no distinct break in residence. He remained in the UK after October 1998 for a settled purpose, to continue to perform the duties of this employment and to continue to see his wife, family and friends.

The court held that due to the fact that the terms "ordinarily" and "residence" has not been defined in the Act, it must be given its normal meaning. The question whether or not a person is an ordinarily resident of a country is a question of fact. No duration of time is specified in the Act and therefore it is necessary to take into account all the facts of the case. The availability of accommodation in the UK must be taken into account and the fact that an individual has a home elsewhere is of no consequence. A person may reside in two places, but if one of those places is the UK he is chargeable to tax in the UK. A person can become a non-resident even if his intention was to mitigate tax. The conclusion of the Court was that the Commissioner's decision is correct.

<u>Oppenheimer v HMRC [2022] UKFTT 122 (TC):</u>

Between 2010/11 and 2016/17, Jonathan Oppenheimer (the taxpayer) received c. £20m from a family trust. HMRC issued assessments to the taxpayer on the basis that he was treaty resident in the UK during the period in which he received the payments from the family trust.

The taxpayer appealed to the UK first tier tribunal (FTT) contending that under Article 4(2) of the double tax treaty between South African and the UK, the taxing rights belonged to South Africa because: (i) that was the state with which his personal and economic relations were closer (his 'centre of vital interests') (Article 4(2)(a)); and (ii) if it was not possible to determine that question, as he had habitual abodes in both territories, then he should be treated as resident in the state of which he was a national and that was South Africa (his 'habitual abode') (Article 4(2)(c)).

The FTT had to determine the country with which the taxpayer's personal and economic relations (centre of vital interests) were closer. The burden of proof was on the taxpayer.

The FTT concluded that throughout the period in question, the taxpayer's personal and economic relations were closer to South Africa. In reaching this conclusion, the FTT looked at various factors, including the location of the taxpayer's wealth, his residential properties, his social ties, places of work and family ties, including his childrens' place of education. In case the FTT was wrong on the centre of vital interest point, it also considered the question of habitual abode and decided that question in the taxpayer's favour.