Tendencies in case law of South African Courts concerning cross-border tax disputes

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Introductory Comments

- Despite 75 comprehensive treaties in force, South Africa has little case law on treaty matters

- Trends or tendencies are difficult to establish

Scope of tax treaties

- **What is a tax?**
- **Shuttleworth (2015) – Constitutional Court**
  - **Dominant purpose of the exit levy was not to raise revenue**
    - Reduce the frequency of the export of capital
    - Not raised through the channels for raising revenue- ie money Bills
    - It was not "calculated" to raise revenue- intended, designed, planned, considered
    - ***The dominant purpose was to control capital flight***
    - Taxation without representation therefore did not apply as the levy was only directed at persons who had sufficient capital above the limits
    - It did not matter if it was a levy, charge or tax, if its dominant purpose was not to raise revenue for the State then it did not have to conform to the formalities required by the Constitution.

Concerns

- **No objective criteria for the meaning of what is a tax**
- Risk that other "behavioural levies" may be raised
- Test currently appears to be a dominant intention test (revenue raising v other)
- Earlier case law (Renzon) had perhaps better objective criteria
- If not a "tax" domestically, doubt as whether a tax for treaty purposes?

Other

- If not a tax and no need for Parliamentary approval?
- No governed limit for extraction of an amount by government from public?
- An attack on no taxation without representation?

Methods of interpretation of tax treaties

- **Tax Court (L.J. Downing) 1972**
  - Taxpayer emigrated to Switzerland but 'blocked assets' invested in portfolio managed by stockbroker
  - Revenue authority argued stockbroker acting on instructions from taxpayer generated a PE (in the alternative at least a dependent agent PE)
- Article 2(3) and 2(4)
  - Art 2(3) "does not justify an inference that exemptions expressly granted in the Convention by one of the contracting States shall be conditional upon the income in question being chargeable under one or other of those taxes of the other State"
- Art2(4) "served to extend its scope by making provision for its applicability to any identical or substantially similar taxes imposed by either country subsequent to the conclusion of the Convention, each country undertaking to notify the other, at the end of each year, of changes in its taxation laws".

Scope of tax treaties

- Taxes covered
  - *Volkswagen of South Africa (Pty) Ltd v Commissioner South African Revenue Service* [2008] ZAGPHC 112 (25 April 2008)
    - Secondary Tax on Companies (introduced after treaty and based on a concept of "net dividends") found to not be a tax on dividends nor substantially similar to the former Non-Resident's Shareholders Tax (NRST)
    - "In the case of STC, the entity liable for the dividend is the company declaring the dividend and the dividend declared is net of tax - on the other hand, a withholding tax such as non-resident shareholder's tax was a tax on the shareholder's dividend income. As far as STC is concerned, same is levied on all South African resident companies when they declare dividends. On the other hand, withholding tax such as non-resident shareholder's tax is applicable only to certain type of shareholders, for example a non-resident shareholder. Furthermore, STC is a tax levied with reference to the net amount of a company's total dividends during a particular period, and on the other hand, non-resident shareholder's tax was levied on the amount of the dividend declared to the affected shareholder"

Scope of tax treaties

- Article 3(2)
  - *ITC 789* 19 SATC 434 (1954)
    - Term 'public company' not defined in treaty (1941 SA-UK)
    - *'In the application of the provisions of the present Agreement by one of the Contracting Governments any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Government relating to the taxes which are the subject of the present Agreement.'*
    - Decision: Term to be defined in terms of South African domestic law – UK company not a public company and no exemption from (now repealed) Non-resident Shareholders Tax (NRST)

Scope of tax treaties

- Article 3(2)
  - *ITC 789* 19 SATC 434 (1954)
    - Issues:
    - No explanation by the court of the application of the general *renvoi*-clause (Art. II(3)) of the treaty
    - No reference to 'context'
    - Should it have had an independent 'third' meaning to reconcile the two tax systems?

Scope of tax treaties

- Article 3(2)
  - *Baldwins (South Africa) Ltd v Commissioner For Inland Revenue* 1961 (3) SA 843 (AD)
    - Decided after ITC 789
    - Same article and issues as in ITC 789
    - SA-UK 1945 treaty
    - "Context" examined only with respect to article in dispute and not whole treaty
      - Must 'clearly show' that meaning to be diverted from domestic law
      - 'General reasons of weight' needed to divert meaning
      - Drawn from domestic law interpretation approach and protection of tax base – correct?
      - Did not exclude possible 'third meaning'

Methods of interpretation of tax treaties

- Tax Court (L.J. Downing) 1972
  - Taxpayer emigrated to Switzerland but 'blocked assets' invested in portfolio managed by stockbroker
  - Revenue authority argued stockbroker generated a PE (in the alternative at least a dependent agent PE)
- Interpretational guidance (SA-Swiss 1967 treaty)
  - Intention from the words used in the treaty – points to purposive interpretation
  - That treaty purpose to avoid double tax did not deny instances of double non-taxation
  - Modification of domestic methods of interpretation needed for international treaty but not to read into the treaty something that does not clearly exist
  - Treaty, where in conflict with domestic law, must override

Methods of interpretation of tax treaties

- *Secretary for Inland Revenue v. Downing* 1975 (4) SA 518(A)
  - Confirmed Tax Court decision and reference to treaty use of "international tax language" accepted
  - Definitions within the treaty must be applied
  - To understand the definition of PE, the article as a whole must be examined

Methods of interpretation of tax treaties

- *ITC 1735* (2002) 64 SATC 45
  - Golfer claimed application of royalties article rather than sportspersons article
  - UK-SA Treaty (1969)
  - Domestic definitions for undefined terms used – but in a limiting manner
  - Glib remarks in the judgment reflect a lack of full comprehension of effect of a treaty

Methods of interpretation of tax treaties

- *Commissioner for the South African Revenue Service v Van Kets* [2011] ZAWCHC 435 (22 November 2011)
  - SA-Australia (1999) treaty
  - Treaty ranks equally with domestic law
  - Must be read with the Income Tax Act as a whole to reconcile any differences
  - Purposive approach applied (definition of "taxpayer" expanded by treaty to include persons from whom information was required in terms of the Exchange of Information article)

Methods of interpretation of tax treaties

- *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] ZASCA 61 (8 May 2012)
  - SA-Luxembourg (2001) treaty
  - Confirms that a "double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict"
  - Accepts *Downing* position that treaties apply an "international tax language"
  - Treaty to be interpreted in light of purpose and congruent with the words used

Methods of interpretation of tax treaties

- *AB LLC and BD Holdings LLC v Commissioner of the South African Revenue Services* [2015] ZATC 2 (15 May 2015)
  - SA-US 1997 treaty
  - Distinguished a Canadian case and stated that the rules of interpretation applied by the Canadian courts are different – see *Krok* later
  - Indicates a need to apply purposive interpretation in context (but does not take historical context of treaty article into account)
  - Does not seemingly take VCLT into account
  - Reliance on a unilateral instrument
  - Deviates from OECD Commentary specifically

Methods of interpretation of tax treaties

- *Krok v CSARS* [2015] ZASCA 107 (20 August 2015)
  - SA-Australia 1999 treaty
  - Accepts that the revenue rule overridden by Assistance in Collection of Taxes article
  - Accepts VCLT as customary international law in South Africa
    - Indicates that the rules are essentially no different than existing rules of interpretation in South Africa
  - Addressed temporal application of new adminstrative provisions (in the absence of more specific clauses, the insertion of an assistance clause is effective with respect to years of assessment from the start of the treaty)
  - Reference to OECD Commentary made only with reference to arguments presented, but indicated that OECD Commentary confirmed court's interpretation

Case law for the application of the concept of residence

- *ITC 1473* (1989) 52 SATC 128
  - Professor clause in SA-German treaty (1973)
  - Temporary absences confirmed as being part of temporary residence for the purpose of the two-year period in the Article.
  - Reference made to, but no reliance placed on, letter from Germany on application of the article denying benefits if the initial contract provided for a period longer than two years

Case law for the application of the concept of residence

- *Oceanic Trust Co Ltd No v. Commissioner For South African Revenue Service* 74 SATC 127
  - Place of effective management (POEM) for SA-Mauritius treaty (1997)
  - Court appears to accept the test from the UK decision in *Smallwood* - but as facts not fully explored in Tax Court did not make a specific ruling on POEM.

Case law for the application of the concept of residence

- *Grundlingh v Commissioner for the South African Revenue Services* (A33/2008) [2009] ZAFSHC 88 (17 September 2009)
  - SA-Lesotho 1997 treaty
  - Both jurisdictions recognised transparent partnerships
  - Partner was the taxable entity and taxed where resident

Case law for the application of the concept of residence

- *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] ZASCA 61 (8 May 2012)
  - SA-Luxembourg (2001) treaty
  - Place of effective management changed as a result of location of board of directors to Luxembourg
  - Time of application of treaty article finding dubious (caused change in domestic law to clarify)

Case law on procedural matters

- *ITC 1364* (1980) 45 SATC 23
  - Double taxation means the taxation of the same income over again or twice in the hands of the same person
  - No question of double taxation arose since neither the duty of appellant's former wife (a different persona) to pay tax on the benefits received by her from him, nor appellant's obligation (legal or moral) to supplement the maintenance payments to her formed any part of appellant's fiscal liability.
  - That the disallowance of the deductions claimed was no more burdensome than that of similarly situated South African nationals and that art 23(1) and(2) (non-discrimination) of the aforementioned double taxation agreement had no application

Case law on procedural matters

- *ITC 1544* (1992) 54 SATC 456
  - Non-discrimination in the imposition of taxation must apply *inter alia* to dividends payable to non nationals of both states; this would appear to be in keeping with international practice
  - The sole criteria for the imposition of non-residents shareholders' tax on the company is the nationality of the company, which manifests a discrimination against such company and is offensive in terms of art 25 (non-discrimination) of the Convention

Case law on procedural matters

- *ITC 1742* (1997) 65 SATC 146
  - Old treaty (SA-Botswana - now replaced) permitting choice of exemption or credit method
  - Credit applied as taxpayer did not discharge onus in showing election of exemption method.

Case law on procedural matters

- *Cohen Brothers Furniture (Pty) Ltd. and Another v Minister of Finance and Others* [1998] ZASCA 15 (23 March 1998)
  - Legislation amended retrospectively to repair discrimination on the basis of nationality found to not retrospectively raise taxes already collected while discriminatory
  - SA-Ciskei treaty (Ciskei not a recognised State by other countries as created in SA by apartheid – was reincorporated into SA in 1994)

Case law on procedural matters

- *Commissioner for the South African Revenue Service v Van Kets* [2011] ZAWCHC 435 (22 November 2011)
  - SA-Australia 1999 treaty amended by protocol
  - Purpose of exchange of information is to provide information requested that the other jurisdiction would have had difficulty obtaining
  - Terms in exchange of information clause must be read in context with the Income Tax Act and may therefore have an influence on domestic definitions

Case law on procedural matters

- *Krok v CSARS* [2015] ZASCA 107 (20 August 2015)
  - Assistance in the collection (and preservation) of assets
  - Entered by protocol
  - Entry into force of article triggered request but applies to any tax year since the start of the treaty
  - Confirmed that above application not retrospective, but acknowledged that a "statute is not retrospective merely 'because a part of the requisites for its action is drawn from time antecedent to its passing'."
  - Claimed change in ownership of SA assets to be considered in terms of SA law

Application of anti-avoidance

- No cases on issues of anti-avoidance in a treaty context
- Tax Court in 1972 confirmed that double non-taxation may well be within the contemplation of the contracting parties
  - Might be challenged more today in context of BEPS

Taxation of dividends

- *ITC 1544* (1992) 54 SATC 456
  - 1971 treaty with the Netherlands
  - Netherlands resident and incorporated company holding shares in South African subsidiaries subjected to non-resident shareholders tax (NRST) (now repealed)
  - Non-resident shareholder's tax found to be discriminatory on basis of nationality
  - Art 25 (non-discrimination) did not create conflict with limited right to tax in Art 10 (if discrimination existed, Art 25 overrides Art 10)

Taxation of dividends

- *Volkswagen of South Africa (Pty) Ltd v Commissioner South African Revenue Service* [2008] ZAGPHC 112 (25 April 2008)
  - Treaty with Germany (1973 treaty)
  - Secondary tax on companies not a tax on dividends but calculated with reference to dividends
  - Tax was payable by company and not shareholder
  - Amounts deemed dividends for the purpose of the calculation equally not dividends for the purpose of the dividends article

Other passive income

- *ITC 1735* (2002) 64 SATC 45
  - Considers royalties, copyright, sportpersons, other income
    - Copyright defined in terms of domestic law
    - Athlete defined by reference to dictionaries and international commentators
  - Odd comment with reference to the "other income" clause

Permanent establishment

- Standard and dependent agent PE
  - Tax Court (L.J. Downing) 1972
  - *Secretary for Inland Revenue v. Downing* 1975 (4) SA 518(A)
- Service PE
  - *AB LLC and BD Holdings LLC v Commissioner of the South African Revenue Services* [2015] ZATC 2 (15 May 2015)

Downing cases

- Mandate provided full discretion to stockbroker
- Art 5(1) and 5(2): “contemplates the situation where, by reason of factors such as occupation and control, the fixed place of business can be said to be the taxpayer's place of business *and does not cover the case where the taxpayer's business is conducted through an agent who himself carries on his own business on his own business premises*”

Downing cases

- Art 5(4) dependent agent not fully argued
- Without deciding: “It is not clear to me whether Smith actually had an authority to conclude contracts ‘in the name of’ respondent; whether art. 5 (4) requires the agent to actually conclude the contracts in question ‘in the name’ of his principal and, if so, whether this occurred when Smith bought and sold shares on respondent's behalf. (Bearing in mind stock exchange practice, it probably did not)”.

Downing cases

- Art 5(5) independent agent
- “reading paras. 4 and 5 together, it seems to me that the emphasis falls broadly upon a distinction between non-independent agents acting habitually on behalf of a non-resident principal and agents of independent status who conduct the business of the principal in the ordinary course of their own business operations. It can readily be appreciated that in the former case the agent could be regarded as a permanent establishment; but in the latter not”.

Service PE – AB LLC and BD Holdings LLC

- **Article 5 DTC US-SA**

- *"(1) For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*
- *(2) The term 'permanent establishment" includes especially –*
- *[a - j]*
  - *(k) the furnishing of services, including consultancy services, within a Contracting State by an enterprise through employees or other personnel engaged by the enterprise for such purposes, but only if activities of that nature continue (for the same or a connected project) within that State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the taxable year concerned."*

Findings of the court

- **Was Art. 5(2)(k) DTC US-SA subject to the conditions of Art. 5(1) DTC US-SA ?**
  - Court: OECD Commentary could provide no assistance in this respect because the OECD MC does not contain an article similar to Art. 5(2)(k) DTC US-SA.
  - Court: OECD Commentary does not take account of the phrase “includes especially” with respect to Art. 5(2)(k)
    - Phrase enlarges scope of Art. 5(1)
    - Unclear why commentary relevant for Art. 5(2)(a) to (f) but not for rest
  - Instead, Vally J placed reliance on the US Technical Explanations, i.e. the application of Art. 5(2 (k) DTC US-SA does not require that the conditions of Art. 5(1) DTC US-SA are met.
  - No real use of VCLT principles (customary law in SA) in interpretation and no historical context applied.

Findings of the court

- **183-day threshold**
  - Applied OECD Commentary from 2005 with respect to Article 15(2) for application of the 183-day rule

- **Fixed place of business**
  - Canadian decision of *Dudney* distinguished
  - Emphasis placed on "partly carried on" and boardroom considered "at the disposal" of the LLCs
  - Court concluded that the requirements of article 5(1) DTC US-SA were met (even if it did not have to decide as such)

- **Additional tax and interest**
  - Additional tax of 100% considered proportional (judicial activism?)
  - Equally no waiver of interest

What trends can be identified?

- Interpretation has varied substantially
  - Highest courts have now affirmed core principles:
    - VCLT customary international law in SA
    - Purposive approach congruent with words used in the treaty
    - Some judges still default to domestic interpretations
- Recent case focussed mainly on procedural aspects
- Insufficient case law for clearly patterns to be identified