UNILATERAL AND DTA TAX RELIEF

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Outline

- Introduction;
- Mechanisms for avoiding double taxation;
- Domestic exemptions;
- The section 6quat credit method;
- The section 6quin credit method;
- Comparison between credit and exemption methods;
- Domestic deductions;
- Other domestic mechanisms;
- DTA relief;
- Article 23A;
- Article 23B;
- Tax sparing;
- Future developments;
- Further reading.
Introduction

- Economic and juridical double taxation;

- Three types of double taxation:
  - Source-source conflicts;
  - Residence-residence conflicts and;
  - Residence-source conflicts.

- Domestic versus tax treaty relief.
Mechanisms to Avoid Double Taxation

• Exemption method;
• Credit method;
• Deduction method;
• Other methods.
Domestic Exemptions where relevant in Cross-border Situations

- Section 10(1)(c)(iii);
- Section 10(1)(c)(iv);
- Section 10(1)(c)(v);
- Section 10(1)(c)(vi);
- Section 10(1)(cG);
- Section 10(1)(gC)(i) and (ii);
- Section 10(1)(h);
- Section 10(1)(j);
- Section 10(1)(l);
- Section 10(1)(m);
- Section 10(1)(o);
- Section 10(1)(p);
- Section 10B(2) and 10B(3).
The Domestic Credit Method (Rebates)

- “Rebate” means a “deduction for an amount to be paid” (SARS IN 18 par 3.1);
- Categories of qualifying income;
- Foreign sourced income qualifies for a rebate in terms of s6quat;
- South African sourced management fees qualify for a rebate in terms of s6quin;
- There is no need for the foreign tax liability to be incurred in the same tax year in which the resident is claiming the rebate (SARS IN 18 par 3.1);
- The term “income” as used in S6quat means income as defined in Section 1 (SARS IN 18 par 3.2). Therefore by implication indirect taxes are excluded;
- Amount of the rebate;
- Maximum amount of the rebate;
- CFC election limitation;
- Carry forward;
- Interaction with DTAs;
- Currency conversion.
Application of Section 6 quat

- Qualifying income:
  - income derived by a resident from a source outside South Africa (see Section 9 and the lecture notes on source);
  - proportional amount included in income in terms of Section 9D;
  - taxable capital gain from a source outside South Africa; or
  - foreign income and/or capital gains attributed to a South African resident in terms of the tax-back rules.

- The “deeming source” rule in a DTA overrides the South African common law and legislative tax rules for determining the source of certain income items and capital gains. e.g. “Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State.”

- Section 6quat provides for a rebate against normal tax, equal to the sum of foreign taxes proved to be payable to a foreign government in respect of qualifying income.
Application of Section 6qua

- An absolute and unconditional legal liability to pay the foreign taxes must exist irrespective of the fact that payment may only be made in the future. The foreign taxes must be legitimately imposed by the relevant foreign sphere of government.

- The rebate is limited to the South African tax which would be payable in respect of the relevant income in a particular year of assessment. Any excess amount (where foreign taxes exceed the South African tax payable in a particular year of assessment) may be carried forward for seven years.

- Timing mismatches: South Africa on an accrual basis whereas foreign country withholds on a cash payment basis. As a result, the South African tax system recognises the underlying income before the income is recognised by the foreign country imposing the withholding tax. Can now re-open assessment to match the income and credit.
Application of Section 6*quat to CGT

- Residents can choose to apply any capital loss first against those capital gains on which no foreign tax liability was incurred;

- Section 9(2) source rules for CGT:
  - Section 9(2)(j) immovable property located in South Africa;
  - Section 9(2)(k) asset not attributable to a foreign PE and not subject to foreign tax.

- Section 6*quat(1)(e) provides a rebate for such non-South African sourced capital gains.
Application of Section 6quat to CGT

- Three-step limitation process applies to the CGT rebate (see SARS IN 19 par 3.3):
  - Step 1 – the comparative inclusion limitation (s6quat(1))
  - Step 2 – The comparative rate of tax on a foreign taxable capital gain limitation (par (iB) of the proviso to S6quat (1B)(a)); and
  - Step 3 – The overall normal tax on taxable income limitation (s6quat(1B(a)));
  - See examples of each step in SARS IN 18.
Application of Section 6quin

• Why introduce section 6quin?
  - A number of African jurisdictions impose withholding taxes in respect of services (especially management services) rendered abroad if funded by payments from their home jurisdictions. The relevant taxes are often withheld in contravention of DTA taxing rights.

• Qualifying income?
  - Taxable income derived by a resident in respect of services rendered in South Africa (i.e. from a South African source).
  - There are no legislated source rules in section 9(2),(3) and (4) that apply to services rendered.
  - The Draft 2011 Taxation Laws Amendment Act included proposals to introduce source rules with the following wording:
    - An amount shall be from a source within the Republic if it is received or accrued in respect of services rendered within the Republic: Provided that if the amount is received or accrued in respect of services which were rendered partly within and partly outside the Republic, only so much of that amount as bears to the total of that amount the same ratio as the period during which the services were rendered in the Republic bears to the total period during which the services were rendered must be regarded as having been received by or accrued to the person from a source within the Republic"
  - The proposed wording was unfortunately not included in the final Bill. Why?
Application of Section 6quin

• Rebate equal to:
  o tax levied by a foreign government with which South Africa has a double tax agreement and which is withheld by the person making the payment; or
  o tax imposed by a foreign government income in terms of their tax laws, where there is no applicable double tax agreement or withholding.

• No reference to “payable” as required in section 6quat.

• Rebate limited to lesser of:
  o the foreign tax withheld or imposed, as the case may be, or;
  o the South African tax which would be payable in respect of the relevant income.

• No carrying forward of excess amounts.

• Rebate not available to the extent that any of the foreign taxes are deducted in terms of s6quat(1C). Why claim a deduction instead of 6quin?
Application of Section 6quin

- Problems with 6quin:
  - SA sourced income but which is deemed by a DTA to be sourced outside of SA.
  - Can 6quat apply? Remember purpose of 6quin?
  - Unlikely that the “payable” requirement in 6quat will be met as often tax is withheld in contravention of the DTA. Result: potential double tax!
  - This problem may be remedied in new 2012 Bill.
Comparison between Credit and Exemption Methods

- Different tax rates;
- Drawbacks;
- Indirect credit method;
- Expenses and losses.
The Domestic Deduction Method

- Section 11(a), section 23(g) and section 23(d);
- Section 6quat(1C);
- Section 6quat(1D);
• Section 6quat(1C)

“For the purpose of determining the taxable income derived by any resident from carrying on any trade, there shall be allowed a deduction from the income of such resident so derived the sum of any taxes on income (other than taxes contemplated in subsection (1A)) proved to be payable by that resident to any sphere of government of any country other than the Republic, without any right of recovery by any person...etc”

• Section 6quat (2)

“The rebate under subsection (1) and the deduction under subsection (1C) shall not be granted in addition to any relief to which the resident is entitled under...[a tax treaty]... but may be granted in substitution for [such] relief...”

• This deduction is only available to residents.
The Domestic Deduction Method, cont.

• Section 6quat(1D)

“Notwithstanding the provisions of subsection (1C), the deduction of any tax proved to be payable as contemplated in that subsection shall not in aggregate exceed the total taxable income (before taking into account any such deduction) attributable to income which is subject to taxes as contemplated in that subsection, provided that in determining the amount of the taxable income that is attributable to that income, any allowable deductions contemplated in sections 11(n), 18 and 18A must be deemed to have been incurred proportionately in the ratio that that income bears to total income”.

• A taxpayer may choose between a rebate and a deduction, if the foreign taxes are applicable in respect of South African sourced income, but a rebate cannot be used to the extent that a deduction has already been claimed.
Other Rebate Mechanisms

- **Section 64N : Rebate in Respect of Foreign Taxes on Dividends**
  - Dividends paid by a non-resident company in respect of South African-listed shares, are “dividends” for purposes of DWT (par (b) of the definition of “dividend” in S64D);
  - If such dividends are subject to both DWT and a foreign tax, then they qualify for a S64N rebate;
  - The rebate is the portion of such foreign tax paid which does not exceed the amount of DWT imposed (S64N(3));
  - The conversion to Rand of the tax, must be done at the same currency conversion rate as that used for converting the dividend (S64N(4));
  - DWT is only paid by residents in the above circumstances, so only residents can claim this rebate.
Other Domestic Law Mechanisms

- Section 9A(1);
- Section 9A(2);
- Other domestic methods.
DTA Relief

- Article 23A – exemption method;
- Article 23B – credit method;
- Tax treaties;
- Examples from some South African treaties;
- Credit in DTA which makes the credit subject to section 6quat and which are not subject to section 6quat. Impact?
Article 23A of the OECD MTC

- Exemption method is an option in both OECD and UN MTCs;
- Exemption given by the Residence State;
- Dividends (article 10) and interest (article 11) excluded, for which a “deduction” (credit) must be given;
- Does not apply if Source State exempts under the treaty;
- This method is favoured by EU countries in their tax treaties, but neither the 1996 US MTC nor the 2006 US MTC contains this method;
- The Swiss DTA is the only SA DTA which contained this method, since replaced under the new Swiss DTA.
Article 23A: Example

- South Africa is entitled to tax the interest income under the residence basis of tax;
- The old Swiss/SA DTA required South Africa to provide an exemption if the interest was attributable to a permanent establishment in Switzerland;
- Switzerland will tax the income but allows certain deemed deductions, with the result that the income effectively escaped tax altogether.
Article 23B of the OECD MTC

- Credit method is an option in both the OECD and UN MTCs;
- Resident state must allow foreign tax as a “deduction”;
- Deduction against tax liability = credit;
- No carry forward;
- Preferred by Anglo-American countries;
- Detailed rules must be determined domestically – SA has no such rules;
- No credit if in a loss;
- Not available against STC for example – STC was not a tax on “income”;
- *Memec plc v Inland Revenue Commissioner.*
Tax Sparing

- Tax treaty credit for notional tax “paid”;
- Example;
- Rationale: tax incentive for economic development;
- Tax avoidance/abuse;
- OECD Report: tax sparing is not recommended, yet several SA tax treaties contain this clause.
Future Developments

- Problems with documentary evidence of payment (see SARS IN 18 par 3.17);
- SAICA documentation initiative;
- UK Inland Revenue FICO brochures.
Prescribed and Recommended Reading

- SARS Interpretation Note 18 (31 March 2009);
- The Practical Guide to Offshore Investments 2006 (Roper, de Kock, Kruger) paragraphs 3.2 – 3.7 (pg 73 – 76);
- Notes on South African Income Tax 2010 (Huxham & Haupt) (29th Edition) (Chapters 4 & 16.4); and
QUESTIONS?

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