AN ANALYSIS OF THE TAX CONSEQUENCES OF THE DOUBLE TAX AGREEMENT BETWEEN SOUTH AFRICA AND THE DEMOCRATIC REPUBLIC OF CONGO

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ABSTRACT

As a result of the different tax systems adopted by countries, foreign-sourced income earned by taxpayers may be subject to double taxation. This may therefore impede cross-border trade and investment. Double taxation relief is provided unilaterally, in terms of a country's domestic laws or bilaterally in terms of Double Taxation Agreements. South African residents earning income from the Democratic Republic of Congo may be subject to tax in both countries. To eliminate such double taxation the South African Income Tax Act, No 58 of 1962, provides for unilateral relief from double taxation in the form of exemptions, rebates and deductions. The double tax agreement between South Africa and the Democratic Republic of the Congo came into effect recently and double taxation relief for South African residents is now also available in terms of tax treaty law.

The objective of the research was to determine whether the combination of the unilateral measures and the double tax agreement provide relief in respect of all types of income earned by South African residents in the Democratic Republic of the Congo.

It was concluded that the double tax agreement, together with the unilateral relief provided for in the Income Tax Act will grant relief for all types of income earned by South African residents in the Democratic Republic of the Congo.

Key words: double taxation agreement, double taxation relief, Democratic Republic of Congo, foreign source income, South African Income Tax Act, unilateral tax relief

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TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION 1

1.1 CONTEXT OF THE RESEARCH 1

1.2 GOALS OF THE RESEARCH 4

1.3 METHODS, PROCEDURES AND TECHNIQUES 4

1.3.1 Scope of the research 5

1.4 OVERVIEW OF CHAPTERS 6

CHAPTER 2: TAX SYSTEMS AND DOUBLE TAXATION 7

2.1 INTRODUCTION 7

2.2 SOURCE-BASED TAXATION 7

2.3 RESIDENCE-BASED TAXATION 8

2.4 THE SOUTH AFRICAN RESIDENCE-BASED TAX SYSTEM 8

2.5 THE DEMOCRATIC REPUBLIC OF CONGO’S SOURCE-BASED TAX SYSTEM 10

2.6 DOUBLE TAXATION 11

2.6.1. Double taxation relief measures: South African approach 12

2.6.1.1. Unilateral relief measures 12

2.6.1.2. Double taxation agreement relief 19

2.7 UNILATERAL RELIEF VERSUS DOUBLE TAXATION AGREEMENT RELIEF 21

2.8 CONCLUSION 21

CHAPTER 3: ANALYSIS OF THE DOUBLE TAXATION AGREEMENT BETWEEN SOUTH AFRICA AND THE DEMOCRATIC REPUBLIC OF CONGO 24

3.1 INTRODUCTION 24

3.2 MODEL TAX CONVENTIONS 24

3.2.1 The OECD Model Tax Convention 25

3.2.1.1 Article 2 – the taxes covered 25

3.2.1.2 Article 4 – Resident 26

3.2.1.3 Article 6 - Income from immovable property 27

3.2.1.4 Article 7 - Business profits 27

3.2.1.5 Article 10 – Dividends 28

3.2.1.6 Article 11 - Interest 29

3.2.1.7 Article 12- Royalties 30

3.2.1.8 Article 13 - Capital gains 30

3.2.1.9 Article 15 - Income from employment 31

3.2.1.10 Article 16 – Directors' fees 32

3.2.1.11 Article 19 – Remuneration in respect of government services 32

3.2.1.12 Article 21 – Other income 33

3.2.1.13 Article 23A and 23B – Methods for the elimination of double taxation 33

3.3 ANALYSIS OF THE SOUTH AFRICA/DEMOCRATIC REPUBLIC OF CONGO DOUBLE TAX AGREEMENT 34

3.3.1 Article 1 – Persons covered 35

3.3.2 Article 2 - Taxes covered 35

3.3.3 Article 4 – Resident 36

3.3.4 Article 6 - Income from immovable property 37

3.3.5 Article 7- Business profits 38

3.3.6 Article 10 – Dividends 39

3.3.7 Article 11 – Interest 41

3.3.8 Article 12 - Royalties 42

3.3.9 Article 13 – Capital gains ... 43

3.3.10 Article 14 – Income from employment ... 45

3.3.11 Article 15 – Directors' fees ... 46

3.3.12 Article 18 – Government service ... 46

3.3.13 Article 20 – Other income ... 47

3.3.14 Article 21 – Elimination of double taxation ... 47

3.4 CONCLUSION ... 48

CHAPTER 4: BENEFITS OF THE SOUTH AFRICA/ DEMOCRATIC REPUBLIC OF CONGO DOUBLE TAXATION AGREEMENT ... 50

4.1 INTRODUCTION ... 50

4.2 BENEFITS OF THE SOUTH AFRICA/DEMOCRATIC REPUBLIC OF CONGO DOUBLE TAX AGREEMENT ... 50

4.2.1 Elimination of double taxation ... 51

4.2.2 Certainty of tax treatment ... 52

4.2.3 Reduction of withholding taxes ... 53

4.2.4 Prevention of tax discrimination ... 54

4.2.5 Resolution of tax disputes ... 55

4.2.6 Benefits of the Double Taxation Agreement for taxpayers ... 55

4.3 DOUBLE TAXATION RELIEF FOR SOUTH AFRICANS EARNING DRC SOURCE INCOME ... 56

4.3.1 Income from immovable property ... 60

4.3.2 Business Profits ... 61

4.3.3 Dividends ... 62

4.3.4 Interest 64

4.3.5 Royalties 65

4.3.6 Capital gains 65

4.3.7 Income from employment 67

4.3.8 Directors' fees 68

4.3.9 Income from government services 68

4.3.10 Other Income 69

4.4 CONCLUSION 69

CHAPTER 5: CONCLUSION 71

5.1 INTRODUCTION 71

5.2 GOALS OF THE RESEARCH 71

5.3 CONCLUSION 74

REFERENCE LIST 76

CHAPTER 1

INTRODUCTION

1.1 CONTEXT OF THE RESEARCH

In October 2013 the South African President stated that South Africa and the Democratic Republic of the Congo (DRC) should explore ways to increase trade and investment between the two countries (SAnews: 2013). This statement was made just over a year after the Double Taxation Agreement ("DTA") between South Africa and the DRC became effective, which also aimed to encourage trade between the two countries. The DTA as well as the President's statement indicate the focus on strengthening the trade relationship between South Africa and the DRC. In the year 2012 South African exports to the DRC were to the value of R12.151 billion and this increased to R13.192 billion in the 2013 year. South Africa also imported goods and services to the value of R6.9 billion from the DRC in 2012 and to the value of R8.9 billion in 2013 (Department of Trade and Industry: 2014). Trade flows between the two countries have shown a positive growth over the years. On 12 November 2011, the energy Ministers of the DRC and South Africa signed a memorandum of understanding which set out broad principles for the signing of the treaty that will enable the development of the first phase of the proposed Grand Inga hydroelectric project on the DRC's Congo River (Department of Foreign Affairs: 2014). The two countries therefore have and will seemingly continue to have an important trade relationship.

Double taxation is generally defined as the imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter (OECD: 2014). Double taxation arises as a result of the following types of conflict:

- Source-source conflicts
- Residence-residence conflicts
- Residence-source conflicts (Olivier & Honiball: 2011)

Countries adopt different systems of taxation; some countries apply the residence basis of taxation while others apply the source basis of taxation. Countries, however, do not strictly apply either a residence or source basis in a pure form but modify the principles to find some common ground (Olivier & Honiball: 2011). The source-source conflict then arises when two countries adopt the source basis principle to tax the same item of income, due to conflicts in

the way the source of income is determined under their domestic legislation (Financing for Development: 2011). Residence-residence conflict occurs where two countries tax a person (individual or company) on world-wide income or capital, because the countries have inconsistent definitions for determining residence (Financing for Development: 2011).

As from 1 January 2001, South Africa applied a residence-based system of taxation (Van Schalkwyk: 2012). This therefore means that South African residents are taxed on their world-wide income and non-residents are taxed on income derived from a source within South Africa. In the DRC, however, resident corporate entities are subject to tax on income derived from activities carried out in the DRC (i.e. source-based) (Katshung: 2014). Non-resident corporate entities as well as individuals are also taxed on income derived from the DRC, which therefore means that all income derived from the DRC is subject to tax in the DRC (Katshung: 2014). Therefore, before the Double Tax Agreement between South Africa and the DRC came into effect, South African companies conducting business in the DRC could be taxed in both the DRC and South Africa, thus the residence-source conflict mentioned above.

Double taxation hinders investment between countries and therefore the DTA entered into between South Africa and the DRC provides an opportunity for increased trade and investment between the two countries. Neumayer (2006:3) states: “By burdening economic activity in a foreign country twice, double taxation can represent an obstacle or barrier to foreign investment.” Double taxation can be avoided unilaterally in terms of domestic law, through relief methods such as the exemption method, the credit method and the deduction method (Olivier & Honiball: 2011). As stated by the Finance for Development Committee (2011:17): “Under the exemption method, a State exempts from taxation certain items of income derived by its residents in another State.” In South Africa most of the exemptions are provided in section 10 of the Income Tax Act No 58 of 1962 (further referred to as ‘the Act’). In the case of the credit method residents are provided a credit for taxes which are payable to a foreign country on the income from a foreign source (Olivier & Honiball: 2011). South Africa provides for such tax credits in section 6*quat* and section 6*quin*. Under the deduction method residents are allowed to claim a deduction for taxes paid to a foreign country on income from a foreign source (Olivier & Honiball: 2011). Section 6*quat*(1C) also provides for the deduction of the foreign tax against the South African taxable income. To avoid double taxation countries have also entered into double taxation agreements.

On 18 July 2012, the DRC doubled the number of DTAs it has entered into, when its DTA with South Africa came into effect (PWC: 2013). Although neither South Africa, nor the DRC are member States of the Organisation for Economic Co-operation and Development (the 'OECD'), the DTA is based on the OECD Model Convention. As stated by the OECD (2014:1) "The OECD Model Convention on Income and Capital provides a means to settle on a uniform basis the most common problems that arise in the field of international juridical double taxation."

The South Africa/DRC DTA provides that business profits of a South African enterprise will only be taxable in the DRC if the South African enterprise carries on business in the DRC through a permanent establishment. In the case of dividends, the DTA provides that dividends paid by a DRC company to a South African are taxable in the DRC, but at a reduced rate of 5 per cent if the South African company directly owns at least 25 per cent of the DRC company. In all other cases the rate is 15 per cent. Article 11 of the DTA provides that interest received by a South African resident from the DRC will be taxable in the DRC at the reduced rate of 10 per cent. Royalties arising in the DRC and paid to a South African resident are taxable in the DRC at the reduced rate of 10 per cent. The DTA also provides that director's fees derived by a South African resident in the person's capacity as a member of the board of directors of a DRC company are taxable in the DRC.

There has been a major legislative change which introduces a new withholding tax amounting to 14 per cent on service fees in the DRC (Binyingo, Slendebroek, Barnes & DeBacker: 2012). As stated by Binyingo *et al* (2012:1): "The withholding tax applies to payments for any type of services made by an individual or company in the DRC to foreign natural or corporate persons not having a presence in the DRC." This therefore makes it important to determine whether the 14 per cent tax rate on service fees applies to South African residents, following the DTA between the two countries. As mentioned previously the DTA between South Africa and the DRC is based on the OECD Model Convention. As a result the DTA should protect the fee income of South African recipients from the 14 per cent withholding tax (Binyingo *et al*: 2012).

Article 3 of the DTA defines 'business' to include the performance of professional services and other activities. This therefore means that if a South African resident receives a fee for the performance of professional services, the fee falls within the ambit of business profits and

will be taxable in the DRC if the South African enterprise carries on business in the DRC through a permanent establishment (PWC: 2013).

Article 20 of the DTA deals with other income and paragraph 3 of Article 20 states that items of income of a resident of a Contracting State that are not dealt with in the DTA, arising in the other Contracting State may also be taxed in that other State. This therefore means that if the service fees earned by a South African resident are treated by the DRC as income, the service fees will be subject to the DRC withholding tax (PWC: 2013).

The DTA recently effected between South Africa and the DRC provides a number of benefits to South African businesses investing in the DRC and *vice versa* by reducing taxes on dividends, interest, royalties and business profits. The DTA between South Africa and the DRC is a recent agreement and there is presently no research critically analysing the DTA and the potential benefits provided by the DTA.

1.2 GOALS OF THE RESEARCH

The research question relates to the tax saving opportunities provided to South African taxpayers by the DTA, as well as whether the combination of the DTA and unilateral measures in South African tax legislation will effectively prevent the double taxation of South African taxpayers.

The goals of the research are as follows:

- To discuss the unilateral measures in the South African Income Tax Act designed to avoid double taxation;
- To analyse the DTA between South Africa and the DRC;
- To set out the benefits provided by the DTA to South African businesses investing in the DRC; and
- To establish whether the unilateral measures and the DTA provide relief from double taxation in respect of all the types of income earned by South African residents in the DRC.

1.3 METHODS, PROCEDURES AND TECHNIQUES

The research follows an interpretative research approach as the main purpose of the present thesis is to analyse the data in order to understand (Babbie & Mouton: 2009). The present

thesis critically analyses the DTA between South Africa and the DRC in order to determine the benefits provided by the DTA. The research methodology can also be categorized as a qualitative research methodology as the research aims to understand and describe and uses natural language argument as a research tool (Brikci: 2007). The research methodology can be described as a *doctrinal* research methodology. This methodology provides a systematic exposition of the rules governing a particular legal category (in the present case the legal rules relating to South African tax legislation and the Double Tax Agreement between South Africa and the DRC), analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2008).

The documentary data used for the research consists of

- Legislation: Income Tax Act No 58 of 1962;
- The DTA between South Africa and the DRC;
- Textbooks and writings of acknowledged experts in the international tax field;
- Articles relevant to international taxation.

The website of Yav and Associates, a service law firm in the DRC, was accessed together with other relevant publications to provide an overview of the DRC tax system.

1.3.1 Scope of the research

The present research focused only on the following Articles in the DTA between South Africa and the DRC:

- Article 2 – Taxes covered
- Article 4 - Resident
- Article 6 – Income from immovable property
- Article 7 – Business profits
- Article 10 – Dividends
- Article 11 – Interest
- Article 12 – Royalties
- Article 13 – Capital gains
- Article 14 – Income from employment
- Article 15 – Directors fees
- Article 18 – Income from government services

- Article 20 – Other income
- Article 21 – Elimination of Double Taxation

According to Article 27 of the DTA, both countries may at any time amend the terms of the DTA. The present research assumes that the DTA will not be materially amended in the near future.

As all the documentary evidence used for the research is in the public domain, no ethical considerations arise.

1.4 OVERVIEW OF CHAPTERS

The thesis is divided into five chapters. Chapter 1 serves as an introduction to the research and sets out the context and the goals of the research. In Chapter 2 the concepts of source and residence will be discussed. It is from this discussion that the causes of international double taxation will be determined. The Chapter will further discuss the South African and Congolese tax systems stating how South African residents earning income from the DRC may be subject to double taxation. To eliminate such double taxation, relief methods are available in terms of domestic law or under the DTA between South Africa and the DRC (further referred to as "SA/DRC DTA"). The Chapter will therefore also discuss South African domestic tax law relief methods available for South African residents earning foreign income.

As double taxation relief is also available in terms of tax treaty law, Chapter 3 will analyse the SA/DRC DTA to determine the tax implications the agreement has for South African residents and the measures in the DTA designed to eliminate double taxation.

Following the analysis in Chapter 3, the benefits of the DTA to South African residents will be set out in Chapter 4. Chapter 4 will also include an analysis in terms of which it will be determined whether the SA/DRC DTA together with the provisions in the Income Tax Act will relieve South African residents from double taxation.

Chapter 5 will provide a summary of the research and the conclusions reached, demonstrating how the goals of the research are addressed.

CHAPTER 2

TAX SYSTEMS AND DOUBLE TAXATION

2.1 INTRODUCTION

To determine a taxpayer's liability for tax, countries adopt a residence or source based system of taxation. Generally countries do not apply only one particular system but adopt elements of both tax systems. As established in terms of a particular country's domestic tax laws, these systems identify who should be taxed and what income should be taxed. The fact that some countries apply the residence system of taxation, while others apply the source-based system of taxation, may result in the same income being taxable in both the country of residence, as well as the source country.

As a background to the thesis, the present chapter explores the concepts of source and residence as well as the causes of international double taxation. The chapter further provides an overview of the South African and Congolese tax systems. The chapter also discusses the measures in the South African Income Tax Act designed to avoid double taxation. This is to address the first goal of the research: to discuss the unilateral measures in the South African Income Tax Act designed to avoid double taxation.

2.2 SOURCE-BASED TAXATION

The right to impose income tax is based on whether there is a connection between income and a country (Olivier & Honiball: 2011). Under the source basis system of taxation only income derived from a source within a particular country is taxed in that country. This tax system does not distinguish between resident and non-resident taxpayers, but all taxpayers are taxed depending on whether the activities that generated the income took place within a certain country's borders (Olivier & Honiball: 2011). Therefore in the case of a source basis of taxation there is a relationship between the income and a particular country.

The justification for source–based taxation is that the source country contributed to the creation of the economic opportunities that allow the taxpayer to derive the income generated within its borders (Financing for Development: 2011). In other words, the country in which the income is generated is compensated for making available its resources for the taxpayer to generate income. The rationale of a source system was also stated in *Kerguelen Sealing and Whaling Co Ltd v CIR*, 1939 AD 487, 10 SATC 363, where it was stated that:

> … presumably, the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live.

2.3 RESIDENCE-BASED TAXATION

As mentioned previously, the right to impose income tax is based on the connection between income and a country. In the case of the residence basis of taxation Olivier and Honiball (2011:19) state that, "Under a residence basis of taxation (also referred to as a world-wide basis of taxation) the connecting factor between the country and the income is the person who receives the income or to whom it has accrued." The residence basis of taxation therefore identifies the resident as the link between the income and the country. Therefore under the residence basis of taxation the resident is taxed on his or her world-wide income regardless of the source of the income.

Olivier and Honiball (2011:19) explain that the rationale for the residence basis of taxation is that "… as a resident enjoys the protection of the State, he/she should contribute towards the cost of the government of the country in which he/she resides, even if the income is earned outside the State." Olivier and Honiball (2011:19) further emphasise that "residents (citizens) know that they can return to the country of residence whenever they want to and that they will have the protection of their government whenever they are abroad." The court indicated the same in *Kerguelen Sealing and Whaling v CIR*, where it was stated that "… presumably . . . a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters him." This system of taxation therefore treats all residents in the same way, regardless of the source of their income.

2.4 THE SOUTH AFRICAN RESIDENCE-BASED TAX SYSTEM

As from 1 January 2001, South Africa applied a residence-based system of taxation (Van Schalkwyk: 2012). As discussed above this means that South African residents are taxed on their world-wide income whilst non-residents are taxed on income derived from a source within South Africa. Therefore, in order to determine whether an amount is taxable in South Africa or not it is important to determine whether the amount in question accrues to a resident or a non-resident.

The South African Revenue Services (further referred to as "SARS") (2014a:1) states that, "Under South African law there are different types of residents, for example a resident defined by the Income Tax Act, 1962 in terms of the so called physical presence test and an ordinary resident in terms of South African common law." A person who is not ordinarily resident in South Africa can therefore still be taxed on his or her world-wide income should he or she meet the requirements of the physical presence test.

The term "ordinarily resident" is not defined in the Income Tax Act however the term has been ascribed a meaning by the courts. In *Cohen v CIR*, 1946 AD 174, 13 SATC 362 it was held that a person's ordinary residence is the country to which he would naturally and as a matter of course return from his wanderings. The concept of ordinary residence was also considered in *Kuttel v CIR*, 1992 (3) SA 242 (A), 54 SATC 298 where it was held that a person is ordinarily resident where he has his usual or principal residence.

According to the definition of "resident" in section 1 of the Income Tax Act, for a person to meet the requirements of the physical presence test the person must be physically present in South Africa for a period or periods exceeding:

- 91 days during the year of assessment as well as 91 days during the five preceding years of assessment; and
- for a period or periods exceeding 915 days in total during the five preceding years of assessment.

A natural person who is not ordinarily resident in South Africa and who does not meet any one of the requirements of the physical presence test will therefore not qualify as a resident in South Africa. A non-resident is any person who is not ordinarily resident in South Africa and fails to meet the requirements of the physical presence test.

In the case of persons other than natural persons, the definition of "resident" in section 1 of the Income Tax Act provides that a resident is a person that is incorporated, established or formed in the Republic or which has its place of effective management in the Republic. The definition further provides that this does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of a Double Taxation Agreement (DTA) between the South African government and the government of the other country party to the agreement.

Non-residents are taxed only on income derived from a source within South Africa. The term source is not defined in the Income Tax Act, but section 9 of the Act determines the source of different types of income. To determine the source of income that is not covered in section 9, one has to look at the common law rules as set out in case law (Haupt: 2013).

The leading authority in the determination of the source of income is *Lever Brothers and Unilever v CIR*, 1946 AD 441, 14 SATC 1. As established in this case, two questions should be asked in determining the source of income and these questions are:

- What is the originating cause of the receipt?
- Where is the originating cause located?

Olivier and Honiball (2008:52) state, "… the first question is to determine what gave rise to the income and only after this has been established can the second question be determined, namely, in which country were the activities which gave rise to the income conducted." In cases where there is more than one originating cause, the dominant cause has to be established and this principle was established in *CIR v Black*, 1957 (3) SA 536 (A), 21 SATC 226 (Haupt: 2013).

2.5 THE DEMOCRATIC REPUBLIC OF CONGO'S SOURCE-BASED TAX SYSTEM

The Democratic Republic of Congo applies the source basis system of taxation (Katshung: 2014). This means that tax is only payable on income earned in the DRC. The concept of residence therefore does not have the same importance as it does in a residence-based system of taxation. There is no statutory definition of the term "source" (SADC: 2014). The Southern African Development Community (further referred to as "SADC") (2014:1) explains that, under Congolese tax law:

- rental income is earned in the DRC when it is derived from letting buildings or land located within the country (Article 4);
- income derived from movable assets is earned in the DRC when the corresponding debtor companies are either duly constituted Congolese companies, or foreign companies established in the Congo (Article 13); and
- business income is earned in the DRC when the business activity takes place within the country (Article 27).

Therefore income relating to activities carried out in the DRC is deemed to have been from a source in the DRC and thus taxable in the DRC. All taxpayers are subject to tax on income derived from activities carried out in the DRC whether such taxpayers are residents of the DRC or not (Katshung: 2014).

2.6 DOUBLE TAXATION

The decision to adopt either source or residence as a basis of taxation is dependent partly on whether a country is a net capital importing country or net capital exporting country. Developing and net capital importing countries generally adopt the source basis of taxation while developed and net capital exporting countries adopt the residence system (Olivier & Honiball: 2008). It is also important to note that no principle is applied in its pure form, but both principles are generally modified to achieve a common middle ground (National Treasury: 2014).

As a result of different countries applying different tax systems, the same income may be subject to tax more than once. Depending on the number of taxpayers involved in a transaction, double taxation can either be juridical or economic. Juridical double taxation refers to the same income being taxed in the hands of the same taxpayer twice (Olivier & Honiball: 2008). Economic double taxation on the other hand, refers to the same income being taxed twice in the hands of two different taxpayers (Financing for Development: 2011). It is important to note that DTAs seek to eliminate juridical double taxation, although in some instances the agreements eliminate economic double taxation (Financing for Development: 2011). It is for this reason that the term “double taxation” in the present thesis refers to juridical double taxation. Double taxation is generally defined as the imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter (OECD: 2014). Double taxation arises as a result of the following types of conflicts:

- **Source-source conflicts**: which arise when two countries adopt the source basis principle to tax the same item of income, due to conflicts in the way the source of income is determined under their domestic legislation.
- **Residence-residence conflicts**: which occurs when two countries tax a person (individual or juristic person) on world-wide income or capital, because the countries have inconsistent definitions for determining residence ; and

- **Residence-source conflicts**: which occurs when one State taxes income derived by a person by the application of the residence principle and the other State taxes the same income by the application of the source principle (Financing for Development: 2011).

South Africa applies the residence-based system of taxation and in the DRC a source-based system of taxation is applied. Should a South African resident earn rental income from the DRC, for example, the income is taxable under South African tax law as residents are taxed on their world-wide income. However, the income is also taxable in the DRC as it is derived from a source within the DRC. This is an example of the residence-source conflict discussed above and such conflict may occur with other types of income earned by South African residents in the DRC.

2.6.1. Double taxation relief measures: South African approach

To reduce or eliminate double taxation, relief measures are usually available under domestic law or under DTAs (Olivier & Honiball: 2008). South Africa provides relief from double taxation both unilaterally and in terms of DTAs. Unilateral relief methods include the exemption method, the credit method and the deduction method (Olivier & Honiball: 2011).

2.6.1.1. Unilateral relief measures

The exemption method

Financing for Development (2011:11) states that "[u]nder the exemption method, a State exempts from taxation certain items of income derived by its residents in another State." In other words, the home country forgoes the taxation of income derived by its residents from a foreign source. The exemption method may be found in domestic law as well as under tax treaty law. However, South Africa mainly adopts the credit method when negotiating its tax treaties (Olivier & Honiball: 2011). Therefore, in a South African context, the exemption method is only applied in accordance with domestic legislation.

Section 10 of the Income Tax Act provides most of the exemptions from income tax found in domestic law (Olivier & Honiball: 2011). It is important to note that the section provides exemptions for income earned both locally and abroad (Van Den Berg: 2011). For the purposes of the present thesis only exemptions provided for South African residents on certain foreign sourced income will be discussed.

Before the introduction of section 10B in the Income Tax Act, section 10(1)(k)(ii) provided an exemption from tax for foreign dividends, in certain circumstances. Presently, the exemption or partial exemption of foreign dividends, under certain circumstances, is provided for in section 10B of the Income Tax Act. According to section 10B(2)(a) a foreign dividend i.e. dividend paid or payable by a foreign company and a dividend paid by headquarter company, is exempt if the South African residents hold at least 10 per cent of the equity shares and voting rights in the company declaring the foreign dividend. This is often referred to as the "participation" exemption. An exemption is also provided for under section 10B(2)(c) for foreign dividends that relate to amounts that have been taxed in the hands of the South African shareholder in terms of section 9D. In terms of section 10B(2)(d) a foreign dividend will be exempt to the extent that the dividend is paid in respect of a listed share and does not constitute a dividend *in specie*. Section 10B(3) provides a partial exemption for foreign dividends received or accrued which are not exempt in terms of section 10B(2). The section 10B(3) partial exemption is calculated in terms of the formula, A= BxC where:

A= the amount to be exempted for a year of assessment

B= the ratio $\frac{25}{40}$ where the person is a natural person, deceased estate, insolvent estate or trust.

B= the ratio $\frac{13}{28}$ where the person is not a natural person, deceased estate, insolvent estate or trust (i.e. companies)

C= the aggregate of any foreign dividends received or accrued to the person during a year of assessment that is not exempt from normal tax in terms of subsection (2).

On or after 1 March 2014 the section 10B(2) and (3) exemption will not apply to any foreign dividend received in respect of services rendered or to be rendered or in respect of or by virtue of employment or the holding of any office (SARS: 2014b).

The Act also provides for an exemption under section 10(1)(o)(ii) for residents receiving remuneration income for employment services rendered outside South Africa for certain specified periods of time (Olivier & Honiball: 2011). Residents earning foreign income are further provided with an exemption under section 10(1)(gC)(i) which exempts from taxation any amount received by or accrued to any resident under the social security system of any other country; or in terms of section 10(1)(gC)(ii) any pension derived by a resident from a source outside South Africa for past employment outside South Africa.

With regard to capital gains, paragraph 64B of the Eighth Schedule to the Income Tax Act provides that, for capital gains tax purposes, any capital gain arising from the disposal of equity shares in foreign companies by a resident is to be disregarded, if certain requirements are met. This is the capital gains tax counterpart of the "participation" exemption (section 10B(2)(a)) referred to above.

The credit method

A critical feature of the credit method, whether it is granted unilaterally or by a tax treaty, is that the country of residence treats the foreign income tax paid to the source country by its residents, within certain statutory limitations, as if it were an income tax paid to itself (Financing for Development: 2011) . In other words, the resident country provides a credit against the taxpayer's tax liability in respect of foreign income taxes paid.

Section 6*quat*

Section 6*quat* of the Income Tax Act provides for a rebate in respect of foreign taxes paid by South African residents on income derived from a foreign source that is included in a resident's taxable income. The rebate is limited to the South African tax attributable to the foreign income (Haupt: 2013). It should further be noted that the rebate is only available to South African residents. Section 6*quat*(1C) also provides for a deduction instead of a rebate in cases where a foreign country levies tax on South African source income (Haupt: 2013). The deduction provided is discussed further under the deduction method below.

As provided in section 6*quat*(1) of the Income Tax Act, the rebate is available on the following types of income:

- any income received by or accrued to a resident from any source outside the Republic
- any proportional amount determined under the controlled foreign company (CFC) rules
- any taxable capital gain from a source outside the Republic
- any amount received by or accrued to the resident from any source outside the Republic and any proportional amount determined under the CFC rules which is deemed to have accrued to the resident in terms of section 7

- any capital gain of any other person from a source outside the Republic which is attributed to the resident in terms of paragraph 68, 69, 70, 71, 72 or 80 of the Eighth Schedule
- any capital of a trust which is included in the income of a resident in terms of section 25B (2A) or taken into account in determining the resident's capital gain in terms of paragraph 80(3) of the Eighth Schedule (Haupt: 2013).

Section 6*quat*(1A) provides that the rebate is the sum of the foreign taxes payable to a foreign revenue service in respect of the types of income mentioned above, without any right of recovery by any person. In other words, if the foreign tax paid is recoverable from the foreign revenue service due to the provisions of a DTA or because of the provisions of the foreign law, the rebate may not be claimed (Haupt: 2013).

The foreign tax payable on the taxable income is pooled and deducted from the South African tax on the total foreign income, however:

- The rebate on a foreign capital gain is limited to the lesser of the foreign tax or the South African tax on that capital gain (provided that the asset is not part of a permanent establishment which the resident has outside South Africa)
- The rebate in respect of certain Controlled Foreign Company income shall be limited to the South African tax on that income (Haupt: 2013).

This therefore means that foreign capital gains are separately pooled as are the proportional amounts included in the income of the taxpayer in terms of section 9D and the foreign taxes in respect of these amounts are similarly pooled. The rebate in respect of each of these pooled amounts is then limited to the South African tax which would be payable in respect of the relevant income in a particular year of assessment. The foreign income and foreign taxes in respect of all other classes of foreign income are pooled and a rebate calculated in respect of this pool.

Section 6*quat*(1B)(a)(ii)(aa) provides that where the sum of the foreign taxes payable exceed the rebate then the excess amount may be carried forward and is deemed to be a tax on foreign sourced income in the following year. The Income Tax Act further provides that this excess amount cannot, however, be carried forward for more than seven years from the year of assessment it was first carried forward. The carry forward of foreign tax does not apply to foreign taxes on capital gains or foreign taxes on certain Controlled Foreign Company income (Haupt: 2013).

Interpretation Note 18 (SARS: 2009) provides a formula to be used to determine the amount of foreign taxes which qualify for the section 6*quat* rebate. The formula is as follows:

$$\frac{Taxable\ income\ derived\ from\ all\ foreign\ sources\ (A)}{Total\ taxable\ income\ derived\ from\ all\ sources\ (B)}\ x\ Normal\ tax\ payable\ on\ (B)$$

The taxable income derived from all foreign sources means all amounts from a foreign source included in the taxpayer's taxable income, regardless of the rate of foreign tax to which those amounts are subject to (Bruwer:2012). Furthermore, section *6quat* does not define "normal tax" for the purposes of the formula above but according to Bruwer (2012) the term "normal tax" means the normal tax payable contemplated in section 5(1) of the Income Tax Act, before the deduction of any rebates.

As SARS (2009) indicates the application of the formula results in normal tax only being reduced by foreign taxes payable on foreign-sourced income, in other words it cannot reduce normal tax payable on South African-sourced income.

Before applying the formula, one has to first identify income from a source within South Africa and income from a foreign source. Taxable income from South African sources and foreign sources must then be determined; this must be done in terms of South African tax principles (SARS: 2009). In calculating the taxable income, any deductible expenditure (i.e. expenditure that meets the requirements for deductibility under a relevant section of the Income Tax Act) incurred which is directly attributable to foreign-sourced income must be deducted from such income; and expenses not directly attributable to the income must be apportioned between the taxable income from a South African source and a foreign source (SARS: 2009). In other words, in cases where a taxpayer is entitled to any allowable deductions, the deductions are deemed to have been incurred proportionally in respect of income derived from sources within and outside the Republic (Haupt: 2013).

In calculating the taxable income from respectively foreign sources and South African sources proviso (i) to section *6quat* (1B)(a) provides that any deductions sought in terms of sections 11(n) (retirement annuity fund contributions), 18 (medical contributions and expenses) and 18A (donations to public benefit organisations) must be apportioned on a *pro rata* basis between income derived from both South African and foreign sources as determined prior to the deduction of any of the amounts contemplated in sections 11(n), 18 and 18A.

Section 6*quat*(2) provides that the rebate shall not be granted in addition to any relief in terms of a DTA, but may be granted in substitution for such relief. This therefore appears to mean that the taxpayer has a choice between section 6*quat* relief and DTA relief.

Furthermore, in terms of section 6*quat*(4) the foreign tax payable is translated to the currency of the Republic at the end of the year of assessment by applying the average exchange rate for that year of assessment.

The section 6*quat* rebate is available for any income received by or accrued to a resident from a source outside the Republic. The rebate will not be available for income from or deemed to be from a source within South Africa. In determining the source of the income it is important to identify whether South Africa has a DTA with the foreign country and, if so, whether the DTA has a "deeming source" provision, as the provision in the DTA overrides the South African tax rules (Snyckers: 2009).

<u>Section 6*quin*</u>

Prior to the introduction of section 6*quin*, in circumstances where income, like management fees, are sourced in South Africa because the relevant management services are performed in South Africa and the management fees are subject to withholding taxes in another country, the section 6*quat* rebate is not available, because the income is not from a foreign source (Olivier & Honiball: 2011). Section 6*quin* was therefore introduced to provide a rebate for foreign taxes paid on income from a source within South Africa. Should the taxable income of a resident include an amount that is received in respect of services rendered in South Africa and

- a foreign country, with which South Africa has a DTA, imposed a foreign tax in respect of those services and the amount of foreign tax was withheld when the amount was paid to the resident, or
- a foreign country, with which South Africa does not have a DTA, imposed a foreign tax in respect of those services rendered

a section 6*quin* rebate is deductible from the resident's tax liability (Bruwer: 2012).

Therefore in cases where South Africa does not have a DTA with the foreign country, the foreign tax charged by the foreign country does not have to be a withholding tax.

Section 6*quin*(1) provides that a rebate must be deducted from the normal tax payable by a resident where the taxable income of the resident includes an amount that is received in respect of services rendered in South Africa, and an amount of tax in respect of that amount is-

- levied by any sphere of the government of a foreign country with which South Africa has a DTA and a foreign tax was withheld when the amount was paid to the resident; or
- imposed by any sphere of government of a foreign country with which South Africa does not have a DTA.

As provided by section 6*quin*(2) the amount of the rebate is equal to the lesser of the amount of normal tax attributable to the amount received or accrued and the amount of tax levied and withheld in the foreign country. Any excess is forfeited and may not be carried forward to the next year of assessment (Bruwer*:* 2012).The rebate is, however, not available for residents who have elected to claim the amount of tax as a rebate under section *6quat*(1) or have elected to deduct the amount of foreign tax levied from their taxable income under section 6*quat* (1C) (discussed below).

To determine the amount of normal tax attributable to the service income from a South African source, the total normal tax payable is apportioned in the ratio that the relevant amount of taxable service income bears to total taxable income (SARS: 2009). As is the case with section 6*quat*, in calculating the taxable income in respect of the service contract, deductible expenses which are directly attributable to the specific service income are deducted from the income and general expenses are apportioned.

The deduction method

The deduction method treats the foreign tax imposed on the resident as an expense and is therefore allowed as a tax deduction. Although South African tax treaties do not provide for the deduction method of double taxation relief, South African domestic law provides for a general deduction for foreign taxes in cases where a rebate under section 6*quat* cannot be claimed (Olivier & Honiball: 2011).

Section 6*quat*(1C) and (1D)

Section 6*quat* (1C) provides that any foreign tax payable may be deducted from the income which is subject to the tax if the income is from a South African source (Haupt: 2013). In other words, section 6*quat*(1C) provides for a deduction from the income of a resident any foreign tax payable that does not qualify for a rebate in terms of section 6*quat*(1) because the income is not from a foreign source. The foreign taxes are only deductible against taxable income derived from the carrying on of a trade in South Africa.

According to section 6*quat*(1D) the deduction under section 6*quat*(1C) should not exceed the taxable income attributable to the income which is subject to the foreign taxes. Any allowable deductions in terms of sections 11(n), 18 or 18A must be apportioned between the income subject to the foreign taxes and the other income, before the foreign taxes are deducted.

Section 64N

Section 64N of the Income Tax Act provides for a further foreign tax deduction. Where a dividend is payable by a foreign company that is dual-listed – listed on both the foreign stock exchange and the Johannesburg Stock Exchange (the JSE) – a dividend tax of 15% is to be withheld from the dividend payable to a shareholder in terms of section 64E of the Income Tax Act (other than to shareholders exempt in terms of section 64F – mainly companies and regulated intermediaries). The dividend may also be subject to tax in the foreign country. In this case section 64N(1) provides for a rebate that is deductible from the dividends tax payable and which, in terms of section 64N(2), "is equal to the amount of tax paid to any sphere of government of any country other than the Republic, without any right of recovery by any person . . .". The rebate is limited, in terms of section 64N(3), to the amount of the dividends tax payable.

2.6.1.2. Double taxation agreement relief

As indicated above double taxation can be addressed unilaterally under domestic law or in terms of double taxation agreements. Section 108 of the Income Tax Act provides that the National Executive may enter into an agreement with a government of any country with a view to prevent, mitigate or discontinue the levying, under the laws of South Africa and of the other country, of tax in respect of the same income, profits or gains, tax imposed on the same donation, or the rendering of reciprocal assistance in the administration and collection of taxes in both countries.

A double taxation agreement (also referred to as 'bilateral tax treaty') is an international agreement, the main aim of which is to provide relief from international double taxation (SARS: 2014c). SARS (2014c:67) also states that "It must, however, be emphasised that a DTA never imposes tax … Its purpose is to allocate taxing rights." As stated by Olivier and Honiball (2008: 37) "… the object of a treaty in general is to avoid the same income being taxed twice, any domestic legislation which has the effect that the same income is taxed twice, will be subordinate to the treaty provisions." This therefore means that the provisions of a DTA override domestic law. In support of this view, Olivier and Honiball (2008) make reference to ITC 1544, 54 SATC 456 where it was held:

> The effect of s 108(2) is to grant statutory relief in certain circumstances where the South African Act imposes a tax, where the provisions of a double taxation agreement grants an immunity or exemption from such tax to persons governed by the Convention. Tax is not payable to the extent to which an immunity or exemption from tax is granted in terms of a binding double taxation agreement which has been proclaimed and has statutory effect.

In other words, when the provisions of a DTA are enacted as part of domestic law they override domestic law (Olivier & Honiball: 2011).

Although South Africa is not a member State of the OECD, South African tax treaties are generally based on the OECD Model Tax Convention. The OECD Model Tax Convention (further referred to as the "MTC") provides for both the exemption method (Article 23A) and the credit method (Article 23B) of relief from double taxation (Olivier & Honiball: 2011). Both these methods are discussed in summary below.

Exemption method- Article 23A

The exemption method provides that the State of residence should exempt tax on income and capital which in accordance with the Convention may be taxed in the other Contracting State (OECD: 2010). This rule however, does not apply where a resident of a Contracting State derives interest or dividends which may be taxed in the other Contracting State (Olivier & Honiball: 2011). To avoid double non-taxation, the Contracting States may negotiate an exception to the obligation to exempt foreign tax by the residence State, where the source State does not tax the person, i.e. exempts the taxpayer from tax under the treaty (Olivier & Honiball: 2011). The exemption method is regarded as the most practical method since it relieves the State of residence from undertaking investigations of the actual taxation position in the other State (OECD: 2010).

The credit method – Article 23B

Under the credit method, the State of residence allows, as a deduction from its own tax on income or capital of its resident, an amount equal to the income or capital tax paid in the other Contracting State (OECD: 2010). Olivier and Honiball (2011:463) state that "The deduction may not exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable to the income or capital which may be taxed in that other State." In other words, the deduction may not exceed the tax liability in the State of residence.

Paragraph 2 of Article 23B also provides that where income or capital is exempt from tax in the State of residence under the treaty, the State of residence may take into account the exempted income or capital when calculating the amount of tax on the remaining income or capital of such resident. The deduction is not claimed as an expense against income but set-off against the taxpayer's tax liability (Olivier & Honiball: 2011).

South African double taxation agreements

SARS (2014c:67) states that "In South Africa, should an amount qualify for relief in terms of the said Article, relief will be granted in the form of a credit." This, as mentioned above, indicates that South Africa adopts the credit method when negotiating tax treaties. Furthermore, SARS (2014c:67) also adds that "Reduced levels of withholding taxes, in situations where double taxation is permitted, are also provided for."

2.7 UNILATERAL RELIEF VERSUS DOUBLE TAXATION AGREEMENT RELIEF

Interpretation Note 18 (SARS: 2009) provides that a resident has the right to choose between the relief provided for in section 6*quat* (i.e. unilateral relief) or tax treaty relief. Interpretation Note 18 only applies to natural persons and even though this is the case, Haupt (2013:462) states that "… it is submitted that the principle is of universal application." Therefore a taxpayer has the option to choose between unilateral relief and tax treaty relief. The Interpretation Note also provides that if no election is made the provisions of section 6*quat* will be applied.

2.8 CONCLUSION

This chapter discussed the concepts of source and residence and identified how the different application of these systems by different countries leads to international double taxation.

Under the source system of taxation only income derived from a source within a country is taxed in that country. This therefore makes it important to determine the meaning of the term "source". The South African Income Tax Act does not define the term "source" but determines the source of various types of income in terms of section 9. To determine the source of income not provided for in section 9 one has to look to the rules laid down in case law. In the *Lever Brothers and Unilever* case it was held that to determine the source of income the originating cause of the income must be determined and the location of that originating cause will determine the source of the income. The Income Tax Act applying in the DRC also does not define the meaning of source but identifies the source of different types of income.

Under the residence system of taxation, residents are taxed on their world-wide income regardless of the source of the income. South Africa applies the residence system of taxation, which therefore makes it important to determine the meaning of a "resident" and this is defined in the Income Tax Act. In the DRC, however, the concept of residence is not crucial as both residents and non-residents are taxed on income derived from a source within the country.

Income derived by South African residents from the DRC, has its source in the DRC and as a resident in South Africa it is also subject to tax in South Africa; this therefore means that both the DRC and South Africa have the right to tax the income.

To eliminate this double taxation the South African Income Tax Act provides relief through provisions in section 10, section 6*quat*, section 6*quin* and section 64N. Section 10 contains exemptions that exempt certain foreign sourced income from a resident's taxable income. Section 6*quat* provides unilateral relief by granting a rebate for foreign taxes paid by a resident. Therefore, the section 6*quat* rebate reduces the taxpayer's normal tax payable. Section 6*quat* also provides a deduction where a resident derives income from carrying on a trade in South Africa, but a foreign country claims source jurisdiction and taxes the income. The deduction is in terms of section *6quat(1C)* which provides for the deduction of foreign taxes from the taxpayer's income. Section 6*quin*, on the other hand, provides a South African resident with a rebate where a foreign tax is paid on income for services provided in South Africa. Therefore, with regard to foreign tax paid on South African sourced income, the taxpayer has the option to deduct the foreign tax in terms of the section 6*quat* deduction or under section 6*quin*. Section 64N provides for a rebate, by way of a deduction from the

South African dividends tax liability, of any foreign tax payable in respect of dividends payable by dual-listed foreign companies.

South Africa has also entered into a DTA with the DRC to resolve the conflict arising from source and residence in the two countries. The DTA is analysed in chapter three.

CHAPTER 3

ANALYSIS OF THE DOUBLE TAXATION AGREEMENT BETWEEN SOUTH AFRICA AND THE DEMOCRATIC REPUBLIC OF THE CONGO

3.1 INTRODUCTION

The previous chapter discussed the concepts of source and residence. The chapter further discussed how the application of different tax systems in different countries, as well as the lack of a universal definition for the concepts of source and residence, may lead to double taxation. Relief from double taxation is provided unilaterally through a country's domestic tax laws as well as bilaterally through double taxation agreements.

South African residents earning income from the DRC are granted relief from double taxation through the application of section 6*quat*, section 6*quin* and provisions in section 10 of the Income Tax Act. From 18 July 2012, these residents were also provided with relief from double taxation bilaterally when the DTA between South Africa and the DRC came into effect (SARS, 2012: Online).

The present chapter analyses and reviews the SA/DRC DTA to provide an understanding of the terms of the DTA and what this means for South African residents investing in the DRC. This will address the second goal of the research: to analyse the DTA between South Africa and the DRC. The DTA follows the OECD Model Tax Convention (MTC) and therefore the chapter firstly reviews the MTC. As indicated in Chapter 1, the present thesis will only focus on certain Articles of the DTA.

3.2 MODEL TAX CONVENTIONS

As stated by Olivier and Honiball (2008:7): "In an attempt to achieve a degree of standardisation of contents of treaties by their members, model tax conventions were published by international organisations." In other words, Model Tax Conventions are published to simplify and standardise the economic situation of taxpayers who are involved in trade activities in other countries (OECD: 2010). By harmonising definitions of important concepts, MTCs avoid conflicts arising from the use of different definitions of the same concepts. Examples of MTCs include the OECD MTC, the United Nations MTC as well as the United States MTC.

3.2.1 The OECD Model Tax Convention

The DTA between South Africa and the DRC is based on the OECD MTC. This therefore makes it important to understand the principles of the MTC. The MTC is published with respect to taxes on both income and on capital and as indicated above it is intended to provide a means of settling common problems arising in juridical double taxation on a standardised basis (OECD: 2010).

The OECD currently has 34 member States and the member States have largely conformed to the MTC when concluding bilateral agreements (OECD:2010). Although it is not compulsory, non-member States have also used the MTC as a basic document of reference in negotiating bilateral agreements (OECD: 2010). This is the case with South Africa and the DRC, where neither country is an OECD member State, but the MTC was used as a reference in negotiating the DTA between the two countries.

The MTC consists of seven chapters. The first chapter describes the scope of the convention, while the second chapter defines certain terms (OECD: 2010). Chapters 3 to 5 specify how States entering into such an agreement may tax different items of income and capital and provide methods to eliminate double taxation. Special provisions follow in chapter six and final provisions, which provide the procedure for entry into force and terms of termination, in chapter seven.

Article 1 and Article 2 are found in chapter 1 of the MTC. Article 1 states to whom the convention applies: that is, residents of the States entering into the agreement. As a result the term “resident” is defined in Article 4, which is discussed below.

3.2.1.1 Article 2 – the taxes covered

Article 2 specifies to which taxes the convention applies. Paragraph 1 of the Article identifies the taxes to which the agreement applies (OECD: 2010). These taxes are limited to direct taxes on income and capital and therefore indirect taxes are excluded (Saunders: 2002). According to paragraph 2 of the Article, taxes on income and capital refer to all taxes on income and capital (OECD: 2010) and the Article specifically provides that such taxes include taxes on gains from the sale or transfer of both movable and immovable property, taxes on salaries or similar remuneration, as well as on capital appreciation (OECD:2010).

Paragraph 3 of Article 2 provides a list of the specific taxes in force at the time the agreement was signed (OECD: 2010). As this paragraph applies to existing taxes at the time of the signing of the agreement, taxes imposed by either of the States after the agreement is entered into are not provided for unless such taxes are significantly similar to the taxes listed in paragraph 3 of the Article (OECD: 2010).

3.2.1.2 Article 4 – Resident

The definition of the term "resident" is important as it determines whether or not the provisions of the convention apply to a particular taxpayer. Paragraph 1 of Article 4 of the MTC provides that a resident of a State is any person who according to the domestic laws of that State is liable to pay tax by reason of his domicile, residence, place of management or any other criterion of a similar nature (OECD: 2010). In other words, any person who is defined or deemed to be a resident in terms of the domestic tax laws of a State is also resident of that State for the purposes of the convention. The paragraph further provides that in the case where a person is considered to be a resident in terms of the domestic laws of a State but is only subject to tax in respect of income from sources within the borders of that State, such person is not a resident in terms of the convention (OECD: 2010).

Where in terms of paragraph 1 of Article 4 a person is considered to be a resident of both the Contracting States then paragraph 2 provides how the person's State of residence should be determined. According to subparagraph *a*) such a person will be deemed to be a resident of the State in which he has a permanent home in (OECD: 2010). Should the person have a permanent home in both States then his State of residence will be the State to which his personal and economic relations are closer (OECD: 2010). Where an individual's personal and economic relations cannot be determined or where the individual does not have a personal home then subparagraph *b*) provides that such person's State of residence is deemed to be the State in which he has an habitual abode (OECD:2010). If the individual has an habitual abode in both States, the individual's State of residence is the State of which he/she is a national (OECD: 2010). If the State of residence cannot be determined in terms of any of the above criteria the States can resolve the issue in terms of the mutual agreement procedure (OECD: 2010).

In the case of a person other than a natural person who is considered to be a resident of both States in terms of paragraph 1, paragraph 3 provides that the person's State of residence is the State in which its place of effective management is located (OECD: 2010).

3.2.1.3 Article 6 - Income from immovable property

Chapter 3 of the MTC specifies how the Contracting States may tax income and capital. Article 6 provides for the allocation of taxing rights with regard to income from immovable property (OECD: 2010). Paragraph 1 of the Article grants the power to tax such income to the State in which the income-producing property is located, that is, the source State (OECD: 2010). According to paragraph 2 the meaning of the concept of "immovable property" should be based on the definition provided under the domestic law of the State in which such property is located (OECD: 2010). Although this is the case, paragraph 2 further provides that property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights related to land, usufruct of immovable property and rights to payments as consideration for the working of or the right to work, mineral deposits, sources and other natural resources must always be regarded as immovable property irrespective of the provisions of the laws of the State in which such property is located (OECD: 2010). Assets such as ships, boats and aircrafts will never be regarded as immovable property (OECD: 2010).

Paragraph 3 of the Article provides that Article 6 applies to income derived from any use of the immovable property (OECD: 2010). In other words, whether the income is generated through direct use or the letting of the property, such income is taxable in the State in which the property is located. The general principle provided in paragraph 1 also applies to income from immovable property of an enterprise, which is defined in Article 3 as the carrying on of any business (OECD: 2010). This therefore means that income from immovable property may be taxed in the State in which the property is located even if the property is owned by a permanent establishment (as defined in Article 5) located in the other State (Olivier & Honiball: 2011).

3.2.1.4 Article 7 - Business profits

Article 7 provides for the allocation of the taxing rights with regard to business profits. According to paragraph 1 of the Article the profits of a business of a Contracting State are taxable only in that State, unless the enterprise has a permanent establishment located in the other State (OECD: 2010). Where the enterprise carries on business through a permanent establishment located in the other State, only the profits that are attributable to such permanent establishment may be taxed in the other State (OECD: 2010). Paragraph 2 of the Article therefore provides how the profits attributable to the permanent establishment should

be determined (OECD: 2010). The paragraph provides that such profits are those the permanent establishment would have made if it was an independent business involved in similar activities and under similar conditions as other businesses in the same industry (OECD: 2010). In other words, the profits of the permanent establishment are determined as if the permanent establishment is a business separate from the main enterprise. There are also other methods of calculating the profits attributable to the permanent establishment and the permanent establishment may select whichever method it wishes, but the method selected has to be consistent every year, unless there is satisfactory reason to apply a different method (Olivier & Honiball: 2011).

Although the term "permanent establishment" is defined in Article 5 of the MTC, differences may arise as a result of different interpretations of paragraph 2. Therefore paragraph 3 provides that the two States must reach an understanding with the application of paragraph 2 and it is also important to have methods available to eliminate double taxation arising as a result of such differences (OECD: 2010).

According to paragraph 4 of the Article, where business profits include items of income specifically provided for in the other Articles of the MTC, then the provisions of Article 7 dealing with business profits will not apply to such income (OECD: 2010). This therefore eliminates uncertainty with regard to which Article to apply when dealing with such income.

3.2.1.5 Article 10 – Dividends

Article 10 of the MTC provides for the taxation of dividends. According to paragraph 1 of the Article dividends paid by a resident company of a Contracting State to a resident of another Contracting State may be taxed in that other State (OECD: 2010). In other words, the dividends may be taxed in the country in which the dividends are received. Paragraph 1 of the Article does not provide a general rule and therefore the dividends may also be taxed in the country in which the company paying the dividends is resident and according to the domestic laws of that country (OECD: 2010). However, where the beneficial owner of the dividends is a resident of the other Contracting State then the dividends must be taxed at the rate of 5 per cent if the beneficial owner is a company which holds at least 25 per cent of the shares of the company paying the dividends and at a rate of 15 per cent in any other case (OECD: 2010).

As a result of the differences between the laws of different countries, paragraph 3 does not fully define the term "dividends" but provides a list of examples of distributions by

companies which constitute dividends (OECD: 2010). According to the paragraph the term "dividends" includes income from shares, rights as well as participating in profits (OECD: 2010), but the list is not exhaustive.

Where the dividends are connected to a permanent establishment located in the State where the company paying the dividends is resident, then the provisions of Article 10 do not apply (OECD: 2010).

3.2.1.6 Article 11 - Interest

Article 11 provides for the taxation of interest. The principle set out in paragraph 1 of the Article is that interest originating in one State and paid to a resident of another State may be taxed in the beneficial owner's State of residence (OECD: 2010). However, the interest may be taxed also in the State in which the interest originated but at the limited rate of 10 per cent of the gross interest (OECD: 2010).

To define the term "interest" OECD (2010:53) states that it includes:

> … 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.

Late payment penalty charges, however, are not included in the definition provided above (OECD: 2010).

Where the interest is connected to a permanent establishment located in the other State then the provisions of paragraph 1 and 2 of Article 11 do not apply (OECD: 2010).

Generally, the source of the interest is the State in which the payer of the interest is a resident, but in the case where the payer of the interest is a permanent establishment and the loan was entered into on behalf of the permanent establishment then the source of the interest is the State in which the permanent establishment is located (OECD: 2010).

Paragraph 6 aims to limit the application of the provisions of Article 11 of the MTC in cases where, by reason of a certain relationship between the beneficial owner and the payer, the amount of the interest paid is greater than an amount that would have been agreed upon if such relationship between the parties did not exist (OECD: 2010). In such situations, the paragraph provides that the provisions of Article 11 will not apply to the amount which is the

difference between the interest paid and the amount that would have been paid if such relationship did not exist between the two parties (OECD: 2010). Therefore the excess amount may be subject to double taxation as the two States may both tax the amount.

3.2.1.7 Article 12- Royalties

Article 12 of the MTC provides for the taxation of royalties. According to paragraph 1 of Article 12, royalties are taxable in the beneficial owner's State of residence (OECD: 2010).

The term "royalties" is defined in paragraph 2 (OECD, 2010: 57) and

> … 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, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

An exception to the general principle in paragraph 1 is found in paragraph 3 of the Article, which provides that in cases where the beneficial owner has a permanent establishment in the State in which the royalties originate and the royalties are paid with regard to property connected with such permanent establishment, then the provisions of paragraph 1 shall not apply (OECD: 2010).

The purpose of paragraph 4 of Article 12 is exactly the same as that of paragraph 6 of Article 11 discussed above. The paragraph aims to limit the application of the provisions of Article 12 of the MTC in cases where, by reason of a certain relationship between the payer and the beneficial owner, the amount of the royalties paid is greater than the amount which would have been agreed upon if such relationship between the parties did not exist (OECD: 2010). In such instances, the paragraph provides that the provisions of the Article shall not apply to the amount which is the difference between the royalties paid and the amount that would have been paid in the absence of the relationship between the two parties (OECD: 2010). This therefore means that the excess amount may be subject to double taxation as the two States may both tax the amount.

3.2.1.8 Article 13 - Capital gains

Article 13 of the MTC provides for the taxation of capital gains. However, the Article leaves to the laws of each State the decision as to whether or not capital gains should be taxed and how the gains are to be taxed (OECD: 2010). The general rule provided by paragraph 1 of

the Article is that gains from the sale or transfer of immovable property may be taxed in the State in which the property is located, that is, the source State (OECD: 2010). However, in the case of movable property which belongs to a permanent establishment, paragraph 2 provides that gains derived from such property may be taxed in the State in which the permanent establishment is located (OECD: 2010).

Furthermore, paragraph 3 provides that gains from the sale or transfer of movable property relating to the operation of ships and aircrafts operating in international traffic and boats engaged in transport in inland waterways are taxable only in the State in which the enterprise is effectively managed (OECD: 2010).

Paragraph 4 of the Article provides for gains from the sale or transfer of shares which derive more than 50 per cent of their value from immovable property located in another Contracting State. In such cases, the paragraph provides that the gains may be taxed in the State which the property is located (OECD: 2010).

With regard to property which is not referred to in any of the paragraphs of Article 13, paragraph 5 provides that such property will be taxable only in the State in which the person alienating the property is a resident (OECD: 2010).

3.2.1.9 Article 15 - Income from employment

Article 14 of the MTC dealt with the taxation of independent personal services and was deleted from the MTC in the year 2000. The taxation of income from employment is now provided for in Article 15 of the MTC. The general rule provided in paragraph 1 of the Article is that income from employment is taxable in the State where the employment services are performed (OECD: 2010). The provisions of paragraph 1 do not apply to directors' fees, pensions and income from government services.

The general rule provided in paragraph 1 is subject to an exception provided in paragraph 2. Paragraph 2 provides that where the,

- employee is present in the State where the employment services are performed for a period/(s) less than 183 days in any 12 month period beginning or ending in the relevant year of assessment, and
- remuneration is paid by an employer who is not a resident, and

- remuneration is not borne by a permanent establishment which the employer has in the State where the employment services are performed,

then the remuneration earned by the employee, who is a resident of a State in respect of employment services performed in the other State, will only be taxed in the employee's State of residence (OECD: 2010).

With regard to the conditions stated above, commentary to the Article provides that the "days of physical presence" method is the only method consistent with the wording of paragraph 2 in calculating the 183 days (OECD: 2010). If the employer has a permanent establishment in the State in which the employment services are performed, the provisions of paragraph 2 will only apply if the remuneration is not an expense that is deductible from the income of the permanent establishment.

In situations where remuneration is received by the employee in respect of employment exercised aboard a ship or aircraft operating in international traffic, the third paragraph of the Article provides that the remuneration may be taxed in the State in which the place of effective management of the enterprise is located (OECD: 2010).

3.2.1.10 Article 16 – Directors' fees

Article 16 of the MTC is concerned with the taxation of directors' fees. The Article provides that directors' fees and other payments received by a resident of a Contracting State, who is a director of a company which is a resident of the other State, may be taxed in that other State (OECD: 2010). In other words, directors' fees are taxable in the State where the company paying the fees is resident.

No definition is provided for "fees and other similar payments" in the Article but commentary to the Article provides that the term has generally been understood to comprise of benefits in kind received by a person in their position as a director of a company (OECD: 2010).

3.2.1.11 Article 19 – Remuneration in respect of government services

Article 19 provides for the taxation of income from government services. The Article provides that salaries and other similar remuneration and pensions paid by a Contracting State to an individual in respect of services provided to that State shall be taxable only in that State (OECD: 2010). This therefore means that the State that makes the payment has the

exclusive rights of taxing the remuneration. This general rule also applies where the remuneration is paid by a political subdivision or local authority of that State (Olivier & Honiball: 2011).

However, where the services are provided in the other State and the recipient of the income is a national and resident of that other State and did not become a resident mainly for the purpose of providing such services, the remuneration is taxable in the State where the services are rendered (OECD: 2010).

It should be noted that the provisions of Article 19 do not apply if the services are performed in connection with a business carried on by such State paying the said remuneration (OECD: 2010).

3.2.1.12 Article 21 – Other income

Article 21 of the MTC provides for the taxation of any income that has not been dealt with in any of the other Articles of the MTC. The Article provides that items of income of a resident of a Contracting State are taxable only in that State (OECD: 2010). In other words, the State of residence has jurisdiction to tax the income.

An exception to this principle is provided in paragraph 2 of the Article. According to this paragraph the principle provided in paragraph 1 will not apply if the income is connected to a permanent establishment (OECD: 2010). Paragraph 2 does not, however, apply to income from immovable property.

3.2.1.13 Article 23A and 23B – Methods for the elimination of double taxation

Chapter 5 of the MTC provides for the exemption and credit method as methods of relief from double taxation. Article 23A and 23B deal with juridical double taxation, which as defined in Chapter 2, occurs when the same income is taxable in the hands of the same person by more than one country (OECD: 2010).

Article 23A- Exemption method

As discussed in Chapter 2, under the exemption method, the State of residence exempts income from tax that, in terms of the Convention, may be taxed in the other Contracting State (OECD: 2010). This does not apply in the case of dividends and interest. Where the income relates to dividend and interest income paragraph 2 states that the State of residence must

allow as a deduction an amount equal to the tax paid in the other State (OECD: 2010). However, the OECD (2010:805) further provides that the deduction should not exceed "… that part of the tax, as computed before the deduction is given, which is attributable to such item of income derived from that other State." In other words, the credit method applies in the case of dividend and interest income. According to paragraph 3 of Article 23A, the State of residence has the power to take the amount exempted in terms of paragraph 1 into account when calculating the tax on the remaining income (OECD: 2010).

The aim of paragraph 4 of the Article is to avoid non-taxation in both States as a result of different interpretations of the provisions of the MTC (OECD: 2010). To avoid double non–taxation, it is provided that paragraph 1 of Article 23A will not apply to income derived by a resident of a Contracting State where the other Contracting State applies the provisions of the double taxation agreement to exempt the same income (OECD: 2010). Therefore the Contracting States may negotiate an exception to the obligation to exempt foreign tax by the residence State, where the source State exempts the taxpayer from tax under the treaty (Olivier & Honiball: 2011).

Article 23B- Credit method

Also discussed in Chapter 2, under the credit method, the State of residence allows as a deduction from its own tax on income or capital of its resident, an amount equal to the income or capital tax paid in the other Contracting State (OECD: 2010). The deduction is however restricted to the part of the tax, as computed before the deduction is given, which is attributable to such item of income derived from that other State (OECD: 2010). In other words, the deduction may not exceed the tax liability in the State of residence attributable to income from the source State.

Like paragraph 3 of Article 23A, paragraph 2 of Article 23B enables the State of residence to take the exempt amount into consideration when determining the tax to be imposed on the rest of the income (OECD: 2010).

3.3 ANALYSIS OF THE SOUTH AFRICA/DEMOCRATIC REPUBLIC OF CONGO DOUBLE TAX AGREEMENT

Countries enter into DTAs to clarify taxing rights, avoid double taxation and prevent tax evasion (Saunders: 2002). The preamble to the SA/DRC DTA (SARS, 2012: Online) sets out the intention and the reason why the agreement was entered into. South Africa and the DRC

have entered into the agreement not only to avoid double taxation but to prevent tax evasion with respect to taxes on income. Like the MTC, the DTA is divided into seven chapters and chapter 1 provides the scope of the agreement in Articles 1 and 2.

3.3.1 Article 1 – Persons covered

Article 1 of the DTA specifies to whom the agreement applies, that is, residents of the Contracting States, in the case of the SA/DRC DTA, South African and Congolese residents.

3.3.2 Article 2 - Taxes covered

Paragraph 1 of Article 2 of the SA/DRC DTA provides that the agreement applies to taxes on income imposed on behalf of the DRC or South Africa, irrespective of the manner in which the taxes are imposed. As the DTA only applies to the elimination of double taxation with regard to taxes on income, paragraph 2 of Article 2 of the DTA is slightly different to the provisions of the same paragraph of the MTC, as the MTC provides for an agreement with regard to taxes on both income and capital. Therefore, taxes on income are defined in paragraph 2 as all the taxes imposed on any elements of income and, as provided in the MTC, including taxes from the sale or transfer of movable or immovable property.

Following the format set out on the MTC, paragraph 3 of Article 2 of the DTA provides that the agreement applies to the Congolese taxes on rental income, investment income, corporate income, profits of liberal professions as well as employment income. In South Africa, the agreement applies to the South African normal tax, secondary tax on companies (further referred to "STC") as well as the withholding tax on royalties. STC was replaced with dividends tax on 1 April 2012 (SARS: 2013). As mentioned above paragraph 3 of the Article applies to existing taxes at the time the agreement was signed. The SA/DRC DTA was signed on 29 April 2005 and STC existed at the time the agreement was signed. Paragraph 4 of the Article is similar to that of the MTC and provides that the agreement also applies to any significantly similar taxes imposed by the two countries to replace or in addition of the existing taxes, after the DTA was signed. STC is a tax levied on dividends declared by a company while dividends tax is a tax charged on shareholders when dividends are paid to them (SARS: 2013). Therefore, STC and dividends tax are taxes on dividends, the main difference lies in who is liable for the tax (SARS: 2013). This means that the taxes are substantially similar and it is submitted that the provisions of the DTA should apply to dividends tax as well.

On 24 September 2012, the DRC also introduced a withholding tax on service fees (Binyingo *et al*: 2012). This withholding tax applies to payments for any type of services performed by a person in the DRC for a foreign natural or corporate person not present in the DRC (Binyingo *et al*: 2012). This tax on service fees is substantially similar to the tax on employment income as both taxes are taxes on income from services rendered. Therefore the DTA should apply to the tax on service fees. However, Binyingo *et al* (2012:1) states:

> … it will remain to be seen whether in practice the DRC authorities will correctly apply the DTA to the service fee income, since it is well known that many African countries are not willing to reduce their withholding tax on fees, even if the DTA requires them to do so.

3.3.3 Article 4 – Resident

Like Article 4 of the MTC, Article 4 of the SA/DRC DTA provides a definition of the term "resident". The provisions of the Article are similar to those of Article 4 of the MTC. In terms of South African law, a natural person is a South African resident if that person is ordinarily resident in South Africa or meets the requirements of the physical presence test, in other words, is physically present in South Africa for a certain period. As previously mentioned, the term "ordinarily resident" is not defined in the Income Tax Act and the question of whether a person is "ordinarily resident" in a country is one of fact (Van Schalkwyk: 2012). In *Cohen v CIR*, the court interpreted the concept to mean the country to which a person would naturally and as a matter of course return from his wanderings. In *Kuttel v CIR*, the court held that a person is ordinarily resident where he has his usual or principal residence.

Where a person is not ordinarily resident, the Income Tax Act provides that such person will be resident if he is physically present in South Africa for periods exceeding:

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

In the case of persons other than natural persons, the Income Tax Act provides that such person is a resident if it is incorporated, established or formed in South Africa or has its place of effective management in South Africa. The Income Tax Act further provides that

this does not include a person who is deemed to be exclusively a resident of another country in terms of a DTA.

Any person who meets the requirements above is a South African resident in terms of South African tax law as well as for the purposes of the SA/DRC DTA.

3.3.4 Article 6 - Income from immovable property

As previously mentioned the DTA applies to all taxes on income and Article 2 of the DTA specifically mentions that such taxes include taxes from the sale or transfer of movable or immovable property. Article 6 of the DTA therefore provides for the allocation of taxing rights with regard to income from immovable property. Paragraph 1 of Article 6 of the DTA is similar to the paragraph in the MTC. This paragraph provides that income from immovable property may be taxed in the country in which the property is located. According to that paragraph of the DTA, such income includes income from agriculture and forestry. Therefore, income derived by a South African resident from immovable property located in the DRC may be taxed in the DRC.

Similar to the MTC, the DTA also provides that the meaning of "immovable property" should be based on the definition in terms of the law of the country in which the property is located. Like the MTC, paragraph 2 of Article 6 of the DTA also provides that property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights related to land, usufruct of immovable property and rights to payments as consideration for the working of or the right to work, mineral deposits, sources and other natural resources must always be regarded as immovable property. Furthermore, the paragraph provides that ships, boats, aircraft and rail or road transport vehicles should not be regarded as immovable property.

As provided by paragraph 3 of the Article, the provisions of Article 6 also apply in cases where the income is derived through the use of the property. In other words, rental income derived by a South African resident from property located in the DRC will also be subject to the provisions of Article 6 of the DTA. Furthermore, the DTA provides that the provisions of Article 6 also apply to income from immovable property of an enterprise.

3.3.5 Article 7- Business profits

Like Article 7 of the MTC, Article 7 of the DTA allocates the taxing rights with regard to business profits and paragraph 1 of Article 7 grants the country in which an enterprise carries on business the exclusive right to tax the profits of such enterprise. However, as provided in the MTC, where the profits relate to a permanent establishment located in the other State the paragraph provides that the profits attributable to the permanent establishment may be taxed in the country in which the permanent establishment is located. Therefore, business profits of a South African enterprise are taxable in South Africa provided that the South African enterprise does not carry on business in the DRC through a permanent establishment located in the DRC. In the event that the South African enterprise carries on business through a permanent establishment in the DRC, the portion of the profits attributable to such permanent establishment may be taxed in the DRC.

The DTA includes the definition of a "permanent establishment" in Article 5, but the Article does not allocate the rights to tax the permanent establishment's profits and consequently does not provide a rule to determine the profits attributable to a permanent establishment (OECD: 2010). For the determination of the profits attributable to the permanent establishment, the DTA provides the same basic rule provided by paragraph 2 of Article 7 of the MTC.

Furthermore, paragraph 3 of Article 7 of the DTA provides that in determining the profits of a permanent establishment, expenses (including executive and general administrative expenses) incurred for the business of the permanent establishment shall be allowed as deductions, whether the expenses are incurred in the country where the permanent establishment is situated, or elsewhere. However, the SA/DRC DTA provides that no deduction will be granted for any amounts

> …paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment.

Conversely, it is provided that where the permanent establishment charges the abovementioned amounts to the head office of the enterprise, such amounts will not be accounted for in the determination of the permanent establishment's profits. The fact that the

DTA elaborates on the income and expenses not to be deducted in the determination of the profits of the permanent establishment limits the possibilities of profit shifting (Siwale, Morel & Mwila: 2014). In other words, it limits the possibility of companies in a group allocating income and expenses between different subsidiaries of the group to reduce the group's tax payable. It is interesting to note that in the SA/Ghana DTA which was signed in 2004, the Article does not mention the expenses not to be deducted in calculating the profits of a permanent establishment.

As stated above, the permanent establishment may select any method of profit attribution. Paragraph 4 of Article 7 of the DTA provides that where a Contracting State usually determines the profits attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts then such method is accepted. However, the paragraph further provides that the results of the method of apportionment should be in accordance with the provisions of Article 7. As provided by paragraph 6 of the Article, the profits to be attributed to the permanent establishment should be determined by the same method every year unless there is satisfactory reason to change the method.

As provided in paragraph 4 of Article 7 of the MTC, paragraph 7 of the DTA provides certainty as to which Article of the agreement to apply when dealing with income expressly provided for in the other Articles of the DTA. According to paragraph 7, where business profits include items of income which are expressly dealt with in the other Articles of the DTA, then the provisions of those Articles shall apply.

3.3.6 Article 10 – Dividends

Paragraph 1 of Article 10 of the DTA is similar to that of the MTC and provides that 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 that other State. In other words, the dividends may be taxed in the State of residence of the recipient. Therefore, dividends paid by a DRC resident company to a South African resident may be taxed in South Africa.

However, this is not an exclusive principle and therefore paragraph 2 of Article 10 allows the DRC to tax the dividends at a limited rate of 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the company paying the dividends, or at 15 per cent of the gross amount of the dividends in any other case.

In the DRC dividends paid out to both residents and non-residents are subject to a 20 per cent withholding tax and 10 per cent for mining companies (Katshung: 2014). Therefore the provisions of the DTA reduce the tax imposed on South African residents. The DTA allows the Contracting States to settle by mutual arrangement the method of application of the limitations.

The DTA in paragraph 3 of Article 10 defines the term "dividends" as income from shares, rights and participating profits but excluding income from debt claims. This is the same definition provided in paragraph 3 of Article 10 of the MTC.

Similar to the MTC, where the beneficial owner of the dividends, for example a South African resident, carries on business in the DRC (that is, the State of residence of the company paying out the dividends) through a permanent establishment located in the DRC and the dividends are paid in connection with such permanent establishment, then the provisions of Article 7 will apply.

Lastly, paragraph 5 of Article 10 of the DTA provides that where a company earns income from the other Contracting State, that other State may not levy any tax on the dividends paid by the company. This principle will not apply:

- Where the dividends are paid to a resident of the State in which the income is derived.
- Where the holding in respect of which the dividends are paid is connected to a permanent establishment located in the State in which the income is derived (Olivier & Honiball: 2011).

The paragraph further provides that the other State may also not subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits comprise of income derived in such other State. Therefore, where a South African resident company derives income from the DRC, the DRC may not levy any tax on the dividends paid by the South African company, unless the dividends are paid to a resident of the DRC or are paid in connection with a permanent establishment located in the DRC. The DRC may also not impose any tax on the South African company's undistributed profits. The OECD commentary on paragraph 5 of Article 10 states that the aim of this paragraph is to rule out the practice by which countries tax dividends distributed by a non-resident company purely because the company's profits from which the distributions are made are derived within that country's borders (OECD: 2010).

3.3.7 Article 11 – Interest

Article 11 of the DTA 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. Therefore, interest derived from Congolese investments and paid to a South African resident may be taxed in South Africa. Paragraph 1 of Article of the MTC establishes the same principle.

As was the case in Article 10, this is not an exclusive principle and paragraph 2 of Article 11 also grants the country in which the interest accrues the right to tax such interest. Therefore, interest derived from investments made in the DRC and paid to a South African resident may also be taxed in the DRC, but at a rate of 10 per cent of the gross interest. The DTA allows the Contracting States to settle by mutual agreement how to apply this limitation.

Under the DRC's tax law, interest paid to a non-resident is subject to a 20 per cent withholding tax. An exemption applies to interest paid to a mining company (Katshung: 2014). Therefore, as a result of the application of the DTA, the tax is reduced to 10 per cent if the non-resident is a South African resident company.

Paragraph 3 of Article 11 provides for situations where the interest accruing in a Contracting State is derived and beneficially owned by the Government of the other Contracting State or political subdivision or local authority, the Central Bank of Congo, the South African Reserve Bank or any wholly owned institution of that Government or subdivision or local authority. The paragraph stipulates that such interest should be exempt from tax in the State where the interest accrues.

The term "interest" is defined in paragraph 4 of the Article and according to the paragraph interest is income from debt-claims, government securities and income from bonds or debentures. This is the same definition provided in paragraph 3 of Article 11 of the MTC.

Furthermore, paragraph 5 of Article 11 provides that where the beneficial owner of the interest, for example a South African resident, carries on business in the DRC (that is, the State in which the interest accrues) through a permanent establishment located in the DRC and the interest paid is in connection with such permanent establishment, then the provisions of Article 7 will apply.

According to paragraph 6 of the Article, interest is regarded as having accrued in a Contracting State when the payer of the interest is a resident of that State. However, the

paragraph further provides that interest will be regarded as interest arising in the State where a permanent establishment is located where the person paying the interest (whether a resident of a Contracting State or not) has a permanent establishment in a Contracting State in connection with which the obligation on which the interest is paid was incurred, and such interest is borne by the permanent establishment. In other words, generally the State of source of the interest is the State in which the payer of the interest is a resident (OECD: 2010).

Paragraph 7 of Article 11 of the DTA is similar to paragraph 6 of the MTC. The paragraph provides that where, by reason of a certain relationship between the beneficial owner and the payer, the amount of interest paid is greater than the amount which would have been agreed upon by the two parties if such relationship did not exist the provisions of the Article only apply to the amount that would have been agreed upon at arm's length (OECD: 2010). As in the MTC, in such cases, the paragraph provides that the excess will remain taxable in South Africa and the DRC.

3.3.8 Article 12 - Royalties

As is the case with Article 12 of the MTC, Article 12 of the DTA provides for the allocation of taxing rights with regard to royalties. Paragraph 1 of the Article stipulates that royalties arising in a Contracting State and payable to a resident of the other Contracting State may be taxed in that other State. Therefore, royalties arising in the DRC and paid to a South African resident may be taxed in South Africa. This is slightly different to the principle provided by paragraph 1 of the MTC. The MTC provides for the principle of exclusive taxation of royalties in the State of the beneficial owner's residence (OECD: 2010).

As provided in paragraph 2 of the Article the royalties may also be taxed in the State in which they arise but at a limited rate of 10 per cent of the gross royalties. The MTC does not provide for such a limitation. Under DRC tax law royalties paid to a resident or non-resident are subject to a 20 per cent withholding tax on the net amount (royalty expenses may be deducted in an amount equal to 30 per cent of the gross payment) (Katshung: 2014). Therefore the withholding tax on royalties is effectively 14 per cent (PWC: 2013). If the royalties are paid to a South African resident the DTA reduces the tax on such royalties to 10 per cent. The DTA does not state whether the Contracting States can settle the application of the 10 per cent limitation by mutual agreement.

Paragraph 3 of the Article defines the term "royalties" and this is the same definition provided in paragraph 2 of Article 12 of the MTC.

Paragraph 4 of the Article provides that where the beneficial owner of the royalties carries on business in the other Contracting State in which the royalties arise through a permanent establishment and the property in respect of which the royalties are paid is connected with such permanent establishment, the provisions of Article 7 will apply. In other words, the royalties will be taxable in the source State as part of the profits of the permanent establishment (OECD: 2010).

Furthermore, according to paragraph 5 of the Article the source of the royalties is the State in which the payer of royalties is a resident. However, the paragraph further provides that where the property in respect of which the royalties are paid is connected to a permanent establishment owned in the other State by the person paying the royalties and the royalties are borne by that permanent establishment, then the source of such royalties is deemed to be the State in which the permanent establishment is located. The person paying the royalties and the owner of the permanent establishment do not have to be a resident of the Contracting State. Therefore, the source of royalties arising in the DRC and paid to a South African resident is the DRC, unless such royalties are connected to a permanent establishment in South Africa.

Paragraph 6 of Article 12 of the DTA is similar to paragraph 4 of Article 12 of the MTC and according to the paragraph in cases where, by reason of a certain relationship between the beneficial owner and the payer, the amount of royalties paid is greater than the amount which would have been agreed upon by the two parties if such relationship did not exist, then the excess will remain taxable in both countries.

3.3.9 Article 13 – Capital gains

Under the DRC domestic law capital gains are fully taxable and subject to the standard rate of corporate income tax (Katshung: 2014). This therefore means that only capital gains realised by persons subject to the corporate tax rate are taxable (Ernst & Young: 2014). In South Africa, on the hand, the Income Tax Act provides that 66.6 per cent, in the case of companies, and 33.3 per cent, in the case of individual taxpayers, of capital gains be included in the taxpayers taxable income. . Article 13 of the DTA deals with the allocation of taxing rights with regard to these capital gains.

Paragraph 1 of Article 13 of the DTA provides the same principle as stipulated in paragraph 1 of Article 13 of the MTC. This paragraph states that gains from the sale or transfer of immovable property may be taxed in the State in which the property is located. Therefore, capital gains derived by a South African resident from the sale of immovable property in the DRC may be taxed in the DRC. As South African residents are taxed on their world-wide income, such capital gains are taxed in both jurisdictions.

In the case of gains from the transfer of movable property which belongs to a permanent establishment, paragraph 2 of Article 13 of the DTA provides that such gains may be taxed in the State in which the permanent establishment is located. This is the same as the principle provided for in the MTC. The paragraph further provides that this rule also applies to the gains derived from the alienation of the permanent establishment. The term "movable property" is not defined in the DTA. The OECD commentary on Article 13, however, provides that the term means all property other than immovable property (OECD: 2010). The definition of "immovable property" is provided in Article 5 of the DTA.

In the case where an enterprise derives gains from the sale or transfer of ships or aircraft operating in international traffic or movable property relating to the operation of such ships or aircrafts, paragraph 3 of Article 13 provides that gains from such sales are only taxable in the State where the enterprise is located. This is the same as the principle provided for in paragraph 3 of Article 13 of the MTC.

Furthermore, the Article provides that gains from the sale or transfer of shares of a company whose property consists mainly of immovable property located in a Contracting State may be taxed in the State in which the immovable property is located. Paragraph 4 of the same Article of the MTC specifically states that the value of the shares that must be derived from immovable property should be more than 50 per cent. The commentary on the article provides that States may either increase or reduce this percentage (OECD: 2010). The DTA however, does not provide a percentage but simply uses the term "principally", which the South African Concise Oxford Dictionary (2007: 927) defines as "for the most part". Generally, "most" refers to more than 50 per cent; therefore it could be held that that the value of the shares that must be derived from immovable property should be more than 50 per cent.

As is also provided in the MTC, for all other capital gains derived from any other property not dealt with in the paragraphs of Article 13, paragraph 5 provides that such gains are taxable only in the country in which the person alienating the property is a resident.

3.3.10 Article 14 – Income from employment

Article 14 of the DTA establishes rules for the taxation of income from employment. Paragraph 1 of the Article provides that, subject to the provisions of the Articles dealing with directors' fees, pensions and income from government services, income from employment is taxable in the State in which the employment services are performed. According to the commentary on Article 15 of the MTC, employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid (OECD: 2010). Therefore, employment income paid to South African residents working in the DRC will be taxable in the DRC unless the South African residents are not physically present in the DRC when performing the activities for which the income is paid. As mentioned above, this does not apply to income in the form of directors' fees, pension and income from government services.

However, income may be taxable in the employee's State of residence in the case of the circumstances referred to in Article 15 of the MTC (see Article 13 – Capital Gains). Therefore, where a South African resident is employed in the DRC and is not present in the DRC for 183 days in a particular year of assessment, and the income earned by such resident is paid by an employer who is not a resident of the DRC and the income is also not borne by the employer's permanent establishment located in the DRC, then the income is taxable in South Africa. Commentary on Article 15 of the MTC states that the purpose of the conditions provided above is to avoid the source taxation of short-term employment to the point that the income is not allowed as a deductible expense in the source country because the employer is not taxed in that country as he is not a resident and has no permanent establishment therein (OECD: 2010). Furthermore, these conditions are also rationalised by the fact that imposing source deduction requirements with respect to short-term employment may constitute an administrative burden where the employer is neither a resident of the source country nor has a permanent establishment in that country (OECD: 2010).

As also provided in paragraph 3 of Article 15 of the MTC, where employment income is paid to the employee in respect of employment exercised aboard a ship or aircraft operating in

international traffic by an enterprise of a Contracting State, the income may be taxed in the country in which such enterprise is located.

3.3.11 Article 15 – Directors' fees

The allocation of taxing rights with regard to directors' fees and other similar payments is provided for in Article 15 of the DTA and Article 16 of the MTC. The provisions of Article 15 are similar to those of Article 16 of the MTC. According to Article 15 of the DTA directors' fees and other similar payments derived by a resident of a Contracting State as a director of a resident company of the other Contracting State may be taxed in the State of residence of the company. Therefore, directors' fees earned by a South African resident who is a director of a DRC resident company may be taxed in the DRC.

3.3.12 Article 18 – Government service

In Article 18 the DTA provides the taxation rules in respect of income derived from government services. Such income is provided for in Article 19 of the MTC. The provisions of Article 18 apply to salaries and other similar remuneration. The Article is set out such that paragraph 1 deals with the taxing rights of salaries, wages and other remuneration whilst paragraph 2 allocates the taxing rights of pensions paid by a government.

Paragraph 1 of the Article provides that salaries and other similar remuneration paid by a Contracting State are only taxable in the State paying such income. However, subparagraph (*b*) of paragraph 1 the Article provides that if the services are rendered in the other Contracting State and the individual is a resident and national of the other State, or did not become resident of such State merely for rendering the services, then the income may be taxed in the individual's State of residence. This therefore means that salaries paid by the DRC government or any authority to a South African resident in respect of services rendered to the DRC will be taxable in the DRC. However, if the services are rendered in South Africa, and the South African resident is also a South African national and did not become a South African resident in order to perform the services, then the income is taxable in South Africa.

Paragraph 2 of the Article applies to pensions paid by a Contracting State to an individual in respect of services rendered to that State. The same principle provided in paragraph 1 applies in respect of such pensions: in other words, the State paying the pension has exclusive rights to tax the income. However, as provided by subparagraph (*b*) of paragraph 1, subparagraph (*b*) of paragraph 2 also states that if the pension is received by an individual who is a resident

and a national of the other State, then the pension is taxable in that other State. As provided by paragraph 3 of the Article, the provisions of Article 18 do not apply in cases where the services are performed in connection with a business carried on by a State.

3.3.13 Article 20 – Other income

As provided by Article 21 of the MTC, Article 20 of the DTA provides a general rule relating to the allocation of taxing rights with regard to income not dealt with in any of the Articles of the DTA. The OECD commentary on Article 21 of the MTC provides that the article concerning the taxation of other income does not only provide for income of a class not expressly dealt with in the other Articles of a convention, but also income from sources not expressly mentioned (OECD: 2010). Paragraph 1 of Article 20 of the DTA provides that such items of income of a resident of a Contracting State, wherever they may arise, will be taxed in the recipient's State of residence.

Where the income (other than income from immovable property) is associated with the activities of a permanent establishment which a resident of one State has in the other State, paragraph 2 of the Article provides that the provisions of Article 20 will not apply.

Although paragraph 1 of the Article allocates an exclusive right to tax such income to the recipient's State of residence, paragraph 3 of the Article further provides that the items of income of a resident of one State which are not dealt with in any of the other Articles of the DTA and arise in the other State, may be taxed in the source state.

This therefore means that where South African residents earn income arising anywhere in the world, such income will be taxed in South Africa. However, where the income arises from the DRC, it may be taxed in the DRC. The MTC does include this paragraph and simply grants the State of the recipient's residence the exclusive right to tax such income.

3.3.14 Article 21 – Elimination of double taxation

As mentioned above, the aim of the SA/DRC DTA is to avoid double taxation and prevent tax evasion. To eliminate double taxation, the MTC provides for the exemption method as well as the credit method; both methods are discussed above. Article 21 of the DTA also provides for both of these methods for the elimination of double taxation. The Article states that double taxation will be eliminated as follows:

- where Congolese residents derive income subject to tax in South Africa, then the DRC shall exempt such income from tax; and
- in South Africa, where South African residents derive income taxable in the DRC, the Congolese tax paid by the South African residents should be deducted from the South African tax liability. However, the deduction is limited to an amount which bears to the total South African tax liability the same ratio as the income concerned bears to the total income.

3.4 CONCLUSION

The SA/DRC DTA is based on the OECD model, which provides a standard format for the provisions of a DTA. This chapter reviewed the provisions of the MTC and established that the provisions of the SA/DRC DTA closely followed the provisions of the MTC. The analysis of the DTA revealed the following basic principles (subject to certain provisions in the various Articles) with regard to the allocation of the taxing rights in respect of different types of income:

- Income from immovable property – may be taxed in the country in which the property is located.
- Business profits – may be taxed in the source State.
- Dividends – may be taxed in the beneficial owner's State of residence. Dividends may also be taxed in the State of residence of the company paying the dividends, but at reduced rates of taxation.
- Interest – may be taxed in the beneficial owner's State of residence. Interest may also be taxed in the State in which the interest arises, but at the reduced rate of 10 per cent.
- Royalties – may be taxed in the beneficial owner's State of residence. Royalties may also be taxed in the State in which the royalties arise, but at the reduced rate of 10 per cent.
- Capital gains – gains from the alienation of immovable property may be taxed in the State in which the property is located. Capital gains derived from the alienation of property not provided for in the Article may be taxed in the alienator's State of residence.

- Income from employment – shall be taxed in the State where the employment is exercised.
- Directors' fees – may be taxed in the State of residence of the company paying the fees.
- Income in respect of government services – shall be taxed in the State paying the remuneration.
- Other income - may be taxed in the recipient's State of residence. Such income may also be taxed in the State in which the income arises.

In each case, where an item of income is connected to a permanent establishment, the DTA provides that such income shall be taxed in the State in which the permanent establishment is located.

The analysis also revealed that the DTA aimed to eliminate double taxation through the application of the exemption and credit methods. In the DRC, income derived by Congolese residents subject to South African tax is to be exempted from tax in the DRC. In South Africa, residents may deduct from South African tax the Congolese tax paid on the income derived from the DRC. This deduction is, however, limited in terms of South African tax legislation.

The following chapter will determine whether the unilateral measures discussed in Chapter 2 and the SA/DRC DTA provide relief from double taxation in respect of all the types of income that could be earned by South African residents in the DRC. The chapter will also set out the benefits of the provisions in the DTA for businesses investing in the DRC.

CHAPTER 4

BENEFITS OF THE SOUTH AFRICA/DEMOCRATIC REPUBLIC OF THE CONGO DOUBLE TAXATION AGREEMENT

4.1 INTRODUCTION

Chapter 3 reviewed the SA/DRC DTA, which is aimed at eliminating the double taxation that arises as a result of the residence-source conflict that occurs when residents from South Africa and the DRC earn income from trade and investment activities conducted with each other. The DTA is also aimed at preventing tax evasion. The DTA is based on the OECD MTC, but certain Articles are different to the MTC. To eliminate double taxation the DTA provides for the exemption and credit method, with both the exemption method (on specified types of income) and the credit method being applied to reduce double taxation for South African residents.

Following the analysis of the SA/DRC DTA in the previous chapter, the present chapter sets out the benefits provided by the DTA. The chapter further determines whether the application of the provisions of the DTA, together with the unilateral measures discussed in Chapter 2, provide relief from double taxation in respect of all types of income earned by South African residents in the DRC.

This chapter therefore addresses the third and fourth research goals: to set out the benefits provided by the DTA to South African businesses investing in the DRC and to establish whether the unilateral measures and the DTA provide relief from double taxation in respect of all types of income earned by South African residents in the DRC.

4.2 BENEFITS OF THE SOUTH AFRICA/DEMOCRATIC REPUBLIC OF CONGO DOUBLE TAX AGREEMENT

SARS (2005) states that the purpose of DTAs is to remove barriers to cross-border trade and investment, thus increasing foreign direct investment flows between the countries party to the agreement. This therefore means that one of the main aims of DTAs is to facilitate foreign direct investment flows. Although it was indicated in Chapter 3 that the SA/DRC DTA is entered into for the avoidance of double taxation and prevention of tax evasion, Olivier and Honiball (2011) state that DTAs provide more than just double taxation relief. SARS (2005) further explains that DTAs remove these barriers through the elimination of double taxation, the provision of certainty with regard to the tax treatment of various items of income, the

reduction of withholding taxes, the prevention of tax evasion, the provision of assistance with the collection of taxes, as well as the provision of tax dispute resolution mechanisms. These therefore constitute the benefits of DTAs and they are discussed below, in the context of the SA/DRC DTA. These agreements provide benefits for both the Contracting States, as well as the taxpayers of these states and therefore the object of the agreement as stated by Olivier and Honiball (2011:276) "… depends on whether the question is asked from the perspective of a taxpayer or from the perspective of one of the Contracting States." The present thesis focuses on the benefits provided by the SA/DRC DTA to South African taxpayers investing in the DRC.

4.2.1 Elimination of double taxation

As previously stated, double taxation discourages investment between countries. With the aim of eliminating double taxation, DTAs allocate the taxing rights of different categories of income between the countries party to the agreement. DTAs further provide methods for eliminating double taxation, should it occur. Articles 6 to 20 of the SA/DRC DTA allocate the taxing rights with regard to different items of income earned by residents from the two countries. This allocation is very important to a foreign investor as it has an impact on the investor's tax burden (Barthel, Busse, Krever & Neumayer: 2010). As the DTA is based on the OECD MTC it allocates greater taxing rights to a taxpayer's country of residence (Sharma: 2013). Daurer and Krever (2012) state that DTAs use three mechanisms for the allocation of taxing rights. The DTA could simply grant exclusive taxing rights to the taxpayer's country of residence or divide the taxing rights between the two countries or allow the source country to retain exclusive taxing rights (Daurer & Krever: 2012).

As shown in the analysis in Chapter 3, Article 7 of the SA/DRC DTA grants the exclusive right to tax business profits of a South African enterprise to South Africa unless the profits are attributable to a permanent establishment located in the DRC. In the case where a permanent establishment is situated in the DRC, both South Africa and the DRC may tax the business income. However, the provisions in Article 21 of the DTA, give the DRC the right to tax such income as South Africa will then credit the Congolese tax paid against the South African resident's tax liability, thus eliminating double taxation. The DTA also grants exclusive taxing rights to South Africa in the case where a South African resident derives any income not expressly provided for in any of the Articles of the DTA, unless such resident derives the income from a permanent establishment located in the DRC.

Another method of allocation, is the division of the taxing rights between the two countries. Most of the Articles of the SA/DRC DTA provide for this method of allocation. For example, in the case of dividends, dividends paid by a Congolese company to a South African investor may be taxed in South Africa and in the DRC (however, at a limited rate in the DRC). As the same dividend income is subject to tax in both countries, the tax paid in the DRC is allowed as a credit against the taxpayer's South African tax, in terms of section 6*quat* of the Income Tax Act, if a dividend exemption in terms of section 10B(2) does not apply. Similar to the taxation of dividends, interest income may be taxed in the investor's State of residence as well as in the source State. The OECD MTC grants exclusive taxing rights to the residence country in the case of royalties. However the SA/DRC DTA has divided such rights between the two countries. This therefore means that the income will be taxed in the DRC and South Africa but, as discussed above, Article 21 of the DTA provides methods to eliminate such double taxation, which apply in South Africa.

Subject to the various provisions stated in Articles 14, 15 and 18 of the DTA, it is only in the case of income from employment, directors' fees, government services and capital gains from the sale of immovable property that the source country is granted the exclusive rights to tax the income.

4.2.2 Certainty of tax treatment

According to Pickering (2013: 12) "One of the main ways in which a developing country can attract foreign investment is by ensuring that the tax environment for investors is clear, transparent and certain." Through the clarification of taxing rights as well as harmonised legislation provided by DTAs, such certainty and clarity is achieved (Siwale *et al*: 2014).

Article 1 of the SA/DRC DTA provides that the DTA applies to South African and Congolese residents, whilst Article 2 stipulates the taxes to which the DTA applies. The provisions of Articles 3, 4 and 5 define the concepts used throughout the DTA. Articles 6 to 20 state where different items of income are taxable and other Articles provide for the prevention of tax evasion. Based on the provisions of all these articles, a South African investor has tax certainty as a result of the provision of details regarding when and how tax will be levied in the DRC. The allocation of the taxing rights between these Contracting States does not only assist in eliminating double taxation but also simplifies the taxation of cross-border trade and investment, especially in cases where the DTA grants the exclusive taxing rights to one country (Pickering: 2013).

The provisions of the articles remain in force indefinitely unless either one of the two countries terminates the agreement through the diplomatic channel; this is provided for by Article 29 of the DTA. Since a country's domestic laws often change, this provides investors with "… legal and fiscal stability [and] hence allow businesses to forecast the maximum tax rate to be incurred and tax exemptions applicable to them" (Siwale *et al*, 2014: 12). In other words, investors will be aware of their tax position with regard to income earned from cross-border trade and investment. Investors are also relieved of the administrative burden of accessing different pieces of legislation to determine the taxation of income derived from cross-border trade (Siwale *et al*: 2014).

4.2.3 Reduction of withholding taxes

The number and rate of withholding taxes are increasing on the African continent (Brandt: 2014). Therefore any agreement that grants an investor the opportunity of reduced withholding taxes is positive. Thus another advantage of DTAs is that they provide for reduced withholding taxes in relation to certain types of income. Where withholding taxes are concerned, the domestic law of a country levies a tax on the non-resident recipient of income but require the person paying the income to withhold the tax (Daurer & Krever: 2012). The DRC imposes a withholding tax on dividends, interest, royalties and service fees. The DTA between the two countries sets a limit on the withholding tax rate that the DRC may impose on such income (with the exception of service fees (see 3.3.2)).

Therefore, in terms of the provisions of the DTA, the DRC can only impose the withholding taxes at the following rates:

- Dividends – 5 per cent, where the investor holds 25 per cent or more of the shares in the company paying the dividends, or 15 per cent in any other case;
- Interest – 10 per cent of the gross interest ; and
- Royalties - 10 per cent of the gross royalties.

In the absence of the DTA, the DRC would impose a withholding tax of 20 per cent on dividends, 20 per cent on interest income and 14 per cent on royalties (Katshung: 2014). Based on the provisions of the DTA, service fees derived by South African residents from the DRC would only be taxed in South Africa if they are classified as business profits and are not attributable to a permanent establishment in the DRC. However, Brandt (2013) explains that

should the DRC treat the service fees as other income in terms of article 20 of the DTA, then the fees will be subject to the 14 per cent withholding tax on the gross amount.

4.2.4 Prevention of tax discrimination

Although an article on non-discrimination included in a DTA was not discussed in the previous chapter, the benefits provided by the SA/DRC DTA include a non-discrimination article. This Article is aimed at ensuring that nationals of one country investing in another are treated with equal fairness as nationals of the country in which they are investing (Siwale *et al*: 2014). The need for this Article arises as foreign investors would find it difficult to compete with local enterprises if the tax burden was heavier on such foreign enterprises (Pickering: 2013).

The SA/DRC DTA provides for such non-discrimination in Article 22. According to Article 22 of the DTA:

- South African nationals may not be subjected to taxation that is more burdensome than Congolese nationals in the same circumstances.
- Stateless persons may not be subjected to taxation that is more burdensome than the nationals of the two countries.
- South African permanent establishments situated in the DRC may also not be subjected to a more burdensome taxation than local enterprises carrying on the same activities. However, paragraph 6 of the Article provides that the DRC may impose a tax not greater than 5 per cent on the profits of the permanent establishment after the deduction of corporate tax relating to such profits.
- Subject to the provisions of Article 9, 11 or 12, interest, royalties and other payments made by a South African enterprise to a Congolese resident may be deducted under the same conditions as if such payments were made to a South African resident.
- Congolese enterprises owned by South African residents may not be subjected to taxation that is more burdensome than enterprises owned by DRC residents.

The non-discrimination rules also apply to the taxes not listed in Article 2 of the DTA and this is provided for in paragraph 7 of Article 22.

4.2.5 Resolution of tax disputes

Even though DTAs provide definitions of certain terms used throughout the agreement, conflict may arise with regard to the interpretation of the Articles. Under such circumstances DTAs provide the Mutual Agreement Procedure Article, which is "… a mechanism for tax administrations to agree on how to interpret or apply treaty provisions, and resolve disputes" (Pickering, 2013: 12). Furthermore, the Article also provides a basis on which disputes between taxpayers and tax authorities may be settled (Saunders: 2002). In other words, where a taxpayer finds that the provisions of the DTA have not been applied correctly, the taxpayer may present the case to the revenue authority in terms of the Mutual Agreement Article, which is Article 23 of the SA/DRC DTA (Pickering: 2013). The provisions of this Article are, however, only available for the taxes covered by the agreement, as provided in Article 2. Taxpayers should also note that the relevant authorities are not obliged to reach an agreement and therefore cases may remain unresolved (Saunders: 2002).

4.2.6 Benefits of the Double Taxation Agreement for taxpayers

The discussion above focuses on the benefits provided by the SA/DRC DTA to South African taxpayers. South Africa, as one of the Contracting States to the agreement, also benefits from the agreement and such benefits include the right to tax certain items of income, assistance in tax collection, exchange of information, as well as the prevention of tax evasion.

Through relief from double taxation, the provision of certainty with regard to the tax treatment of cross-border transactions, the reduction of withholding taxes and the prevention of tax discrimination, DTAs are said to remove barriers to cross-border trade and investment SARS (2005). Different studies, however, come to different conclusions on the significance of the impact DTAs have on foreign direct investment. For example, according to Hearson (2013) DTAs are unnecessary for the elimination of double taxation as the residence countries provide double taxation relief unilaterally. Although this might be the case, UNCTAD (2009:19) states that "a tax treaty can be useful as it generally offers greater and more comprehensive protection than that available under domestic rules which can be modified at will." Therefore even if unilateral relief is provided domestically, DTA relief is more stable, which brings some level of comfort to investors.

Although Hearson (2013) further concludes that there is no evidence that DTAs increase the overall levels of investment in a country, UNCTAD (2009) claims that DTAs contribute to an

improved investment climate. It is notable that foreign direct investment is determined by a number of factors and DTAs alone may not necessarily result in increased foreign direct investment flows, but they do contribute to it (Siwale *et al*: 2014).

In the case of the SA/DRC DTA, PWC (2013:1) states that the agreement "provides [the] opportunity to promote South Africa as a hub for inward investment into the DRC." In terms of the benefits detailed above, the DTA provides South African and other foreign investors (who hold investments through South Africa) with a stable tax environment which encourages foreign investment.

4.3 DOUBLE TAXATION RELIEF FOR SOUTH AFRICANS EARNING DRC SOURCE INCOME

Taxpayers deriving foreign income which is taxable in both the resident country and the source country are granted relief from double taxation unilaterally under a country's domestic laws as well as bilaterally through DTAs. South African residents earning income from the DRC are relieved from double taxation through the application of sections 6*quat*, 6*quin* and 64N of the Income Tax Act. Relief is also provided by means of exemptions granted in section 10 of the Income Tax Act. Furthermore, with the SA/DRC DTA coming into effect, such residents are also granted relief through the provisions of the DTA.

Before it can be established whether these methods provide relief in respect of all the types of income earned by South African residents in the DRC, it is important to first understand when such methods can be applied.

SARS Interpretation Note 18 (SARS: 2009) states that the primary mechanism to alleviate double taxation is section 6*quat*. As discussed in Chapter 2, section 6*quat* of the Income Tax Act grants South African residents a rebate in respect of foreign taxes proved to be payable by such residents on the foreign source income included in their taxable income. This therefore means that before a taxpayer is granted relief in terms of section 6*quat* the following requirements must be met:

- a South African resident must have paid or have been required to pay foreign taxes on income from a foreign source;
- the resident must have the legal liability to pay the foreign taxes without a right of recovery, either through a refund or the provisions of the DTA (Haupt: 2013); and

- the foreign income to which the taxes are paid must have been included in the resident's taxable income.

Where all the above requirements are met the resident may then be granted a rebate in terms of section 6*quat*. The rebate is limited to an amount calculated in terms of the formula provided in Chapter 2. Essentially, the formula reduces the South African tax payable by the foreign taxes paid by the resident on the foreign income included in his/her taxable income, but limited to the attributable South African tax. The taxpayer may carry forward any unused foreign tax credit to the following year of assessment, except in the case of foreign capital gains and income allocated to a South African in terms of the provisions of section 9D of the Income Tax Act (in respect of controlled foreign companies). Olivier and Honiball (2011) state that even when a taxpayer does not have any South African tax payable, it is SARS' practice to allow the section 6*quat* rebate to be carried forward. Section 6*quat*(1B)(ii)(bb) provides that the excess amount brought forward from a previous year may only be used after the current year rebate has been used and any unused portion may be carried forward for a period of no more than seven years. The taxpayer may therefore, under certain circumstances, never use up the excess rebate (De Souza Drummond: 2012).

As can be noted from the requirements above, relief in terms of section 6*quat*(1) will not be granted where the income is from a South African source. Therefore where income is from a South African source, in terms of the South African source rules, then the section 6*quat*(1) rebate is not available to the resident, but rather a section 6*quat*(1C) deduction of the foreign tax against the South African taxable income may be claimed. Should the income that is from a South African source be service fee income then, instead of the section 6*quat* (1C) deduction, the taxpayer has the election to be granted a rebate in terms of section 6*quin*. As discussed in Chapter 2, because South Africa has concluded a DTA with the DRC, the section 6*quin* rebate is only available where the payer of the service income has withheld the foreign tax when paying the income to the South African resident (Bruwer: 2012). Therefore to qualify for a section 6*quin* rebate in respect of services provided to a resident of the DRC, the following requirements must be met before the resident is granted relief:

- foreign taxes must have been withheld by the DRC resident when paying the amount to the taxpayer;
- the amount to which the taxes are paid must have been included in the taxpayer's taxable income; and

- the resident must submit a return within 60 days from the date on which the tax was withheld.

As discussed in Chapter 2, the amount of the rebate is the lesser of the foreign taxes withheld and the South African tax attributable to the service income. The excess amount of the taxes cannot be carried forward (Haupt: 2013). According to Oosthuizen (2013) the calculation of the rebate is quite difficult as it determined on a per project basis, thus requiring the taxpayer to determine the taxable income of each project, which in turn makes the allocation of expenses crucial.

As previously mentioned, the taxpayer can also deduct the foreign tax that has been imposed on South African sourced income which has been subject to foreign taxes, in terms of section 6*quat*(1C). To qualify for a section 6*quat* (1C) deduction the following requirements need to be met:

- foreign taxes must have been imposed on South African source income derived from the carrying on of a trade;
- the resident must have legal liability to pay the foreign taxes without a right of recovery; and
- the income to which the taxes are paid must have been included in the taxpayer's taxable income.

The deduction may not, however, exceed the taxable income attributable to the income that is subject to the foreign taxes (section 6*quat* (1D)).

In the case of DTA relief, before a resident is granted relief in terms of the SA/DRC DTA, the foreign taxes paid or payable by the resident must constitute the taxes covered in Article 2 of the DTA. Article 21 grants South African residents double taxation relief in terms of the credit method. According to Article 21, this method of relief is granted "subject to the provisions of the law of South Africa regarding the deduction from tax payable in South Africa of tax payable in any country other than South Africa". This therefore means that the credit to be granted to the taxpayer should be calculated in terms of section 6*quat*. As the DTA is subject to the provisions of section 6*quat* a resident electing the DTA relief should be able to carry forward any excess credit to future years of assessment, whereas in any other case the excess is forfeited.

Furthermore, Article 21 of the DTA also states that the credit should not exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income. Therefore the rebate as calculated in terms of section 6*quat* will be limited further to an amount calculated as follows:

$$\frac{taxable\ income\ concerned}{total\ taxable\ income}\ x\ total\ South\ African\ tax\ payable$$

Where,

Total South African tax = normal tax before the section 6*quat* rebate

Taxable income concerned = income taxable in both South Africa and the DRC

Total taxable income = total taxable income from all sources

The formula above limits the rebate to the portion of the South African tax that relates to the income taxed in both South Africa and the DRC.

Since the DTA relief is subject to the provisions of section 6*quat* it does not seem necessary for a taxpayer to elect such relief as it does not provide any added benefits for the taxpayer. The draft Interpretation Note 18 (Issue 3) (SARS, 2014d:66) even goes as far as stating:

> An article of this nature effectively means that section 6*quat*(1) is often practically the only method available for determining a foreign tax rebate in respect of foreign-sourced income under a tax treaty which contains a 'subject to' provision.

Interpretation Note 18 (Issue 2) also states that "if such an article applies, section 6*quat* effectively provides the only method for determining the tax credit." (SARS, 2009:34). Therefore, although relief is granted in terms of the SA/DRC DTA, South African residents in practice have to rely on the unilateral measures provided in the Income Tax Act for double taxation relief, rather than Article 21 of the DTA.

The section below applies the provisions of the DTA and unilateral measures for double taxation relief to different items of income earned by South African residents from the DRC, to determine whether these measures succeed in eliminating double taxation.

4.3.1 Income from immovable property

Although the Income Tax Act does not specifically define the term "source" section 9 of the Income Tax Act provides the source of various types of income. In terms of section 9(2)(j) of the Income Tax Act the source of income from immovable property is South Africa where an amount is received or accrued in respect of the disposal of an asset that constitutes immovable property or any interest in or right to immovable property contemplated in paragraph 2 of the Eighth Schedule and that property is situated in South Africa. This therefore means that the source of income from immovable property is the country where the property is located. This is the same principle determined in case law. *Liquidator, Rhodesian Metals Ltd v COT*, 1938 AD 282, 9 SATC 363 stated that, "source means, not a legal concept, but something which a practical man would regard as a real source of income". This therefore means that "each case has to be decided on its own facts" (Van Schalkwyk, 2012:64). In *Liquidator, Rhodesian Metals Ltd v COT* the court held that the source of income was where the capital is employed. A company, registered in England disposed of mining claims located in Rhodesia, to another company (also registered in England). The court held that the "risk of depreciation or the hope of appreciation was attached to the Rhodesian acquisition." In other words, the cause of the profit was the employment of capital in Rhodesia (Van Schalkwyk: 2012). Applying the principle from the *Liquidator, Rhodesian Metals Ltd v COT* case, the source of income derived from the use of immovable property will be where the property is located as this is where the capital is used in order to acquire the income.

In *COT v British United Shoe Machinery (SA) (Pty) Ltd*, 1964 (3) SA 193 (FC), 26 SATC 163 the court held that when the emphasis is on the property and not the business of the lessor, the source of the income derived from the property is where the property is used. Therefore, the source of rental income derived from immovable property is where the property is situated, whilst the source of income from, for example, car rentals is where the business is situated (Van Schalkwyk: 2012).

Therefore, rental income derived from immovable property situated outside South Africa constitutes foreign source income.

In terms of the provisions of Article 6 of the SA/DRC DTA, rental income derived by South African residents in respect of property situated in the DRC may be taxed in the DRC. Since the DTA does not grant the DRC an exclusive right to tax such income this means that such

income may also be taxed in South Africa. Since the income is derived from a foreign source, included in the taxable income of the South African resident and the tax on this income is payable by the resident to the DRC authorities, relief in terms of the section 6*quat* rebate will be granted to the resident. The taxpayer could also elect relief in terms of Article 21 of the DTA, but it is unlikely that the taxpayer would elect relief in terms of the DTA where the DTA is subject to the provisions of section 6*quat*, as is the case in the SA/DRC DTA.

4.3.2 Business Profits

The source of business income is not provided for in section 9 of the Income Tax Act and therefore to determine the source of business income case law principles are applied. According to Van Schalkwyk (2012), the originating cause of business income is the activities performed to generate the profits and therefore the source of the income is where such activities are performed. In the case of services rendered, the source is therefore where the services are rendered (Haupt: 2013).

As provided in Article 7 of the SA/DRC DTA, business profits derived by a South African resident are exclusively taxable in South Africa unless the profits relate to a permanent establishment located in the DRC. Therefore although business income may be generated by South African residents from the DRC, the income is not taxable in the DRC unless the resident has a permanent establishment in the DRC. In a situation where the DRC authorities do not apply the provisions of the DTA and (incorrectly) tax business on income despite the fact that a South African resident does not have a permanent establishment in the DRC, relief cannot be provided in terms of section 6*quat,* even though the income is from a foreign source. For a section 6*quat* rebate to be granted the foreign tax paid by the taxpayer must have legal liability to pay the tax and, as stated in Interpretation Note 18 (SARS: 2009) such liability only arises when the foreign country has the right to tax the income. In such cases the taxpayer can, as provided by Article 23 of DTA, present the case to SARS to resolve the dispute. Although this is the case, it has been explained that this process may take a long time and, according to Saunders (2002), a number of cases remain unresolved for a number of years. Daurer and Krever (2012) also note that it would be difficult for a country to collect taxes on business income derived by a foreign company which does not have a permanent establishment in that country. However, this would not be the case where the

foreign business has high publicity and requires services provided locally to carry out business transactions (Daurer & Krever: 2012).

Where the South African resident has a permanent establishment in the DRC, the DTA provides that the DRC may tax the income relating to the permanent establishment. The use of the words "may tax" suggests that South Africa may also tax the income. The taxpayer is then granted relief in terms of Article 21 of the DTA or section 6*quat*. The section 6*quat* rebate is available in this case as the income is:

- derived from a foreign source;
- included in the taxpayer's taxable income;
- subject to tax in the DRC and the DRC has a right to tax such income in terms of the DTA.

The DRC imposes a withholding tax of 30 per cent of the gross amount on technical service fees (Deloitte: 2014). In the case of a South African resident the DRC can only withhold such taxes if the resident has a permanent establishment in the DRC. However, where the resident has a permanent establishment in the DRC then the DRC may rightfully impose such a tax on the resident. Unilateral relief granted to the taxpayer in this regard will depend on whether the services are rendered in the DRC or in South Africa. An example to illustrate this is the case where a South African consulting company with offices in the DRC, offers its services to a client in the DRC and the research or designs required in order to advise the client are prepared in South Africa, the services are rendered in South Africa. This therefore means that the source of the service income is South Africa and relief in terms of section 6*quat*(1) is not available for the taxpayer, but will be provided in terms of section 6*quin* or section 6*quat*(1C).

4.3.3 Dividends

Through the application of section 10B of the Income Tax Act South African residents are granted relief (or partial relief) in respect of dividend income received from foreign companies. As discussed in Chapter 2, section 10(2) states that foreign dividends received by or accrued to South African residents are exempt in the following cases:

- where South African residents hold at least 10 per cent of the equity shares and voting rights in the company declaring the dividend;

- where the foreign dividends are received from amounts that have been taxed in terms of section 9D;
- where the foreign dividends are received by a natural person in respect of listed shares and do not constitute dividend in specie; and
- where the foreign dividends are received by a South African resident company in respect of listed shares, the exemption includes dividend in specie.

Furthermore, foreign dividends not exempt in terms of section 10B(2) are then partially exempted in terms of section 10B(3). The part to be exempted in terms of section 10B(3) is calculated as either $\frac{25}{40}$ in the case of an individual or trust or $\frac{13}{28}$ in the case of a company, of the aggregate foreign dividends.

The definition of a "dividend" is provided in paragraph (b) of section 64D of the Income Tax Act and includes dividends paid by a foreign company in respect of shares listed in South Africa. Therefore, foreign dividends paid by non-resident companies listed on Johannesburg Stock Exchange (further referred to as "JSE") are subject to dividends tax. Dividends tax is a separate tax from normal tax and is imposed in terms of section 64E of the Income Tax Act. Where a South African resident earns such dividends and the dividends were subject to a foreign tax, section 64N of the Income Tax Act provides the taxpayer with relief. Relief in terms of section 64N is only available where:

- the beneficial owner was liable for dividends tax;
- the foreign tax was paid or is payable by the resident without any right of recovery.

Section 64N(1) provides that the rebate is to be deducted from the dividends tax payable. The rebate is also limited to the 15 per cent dividends tax imposed (section 64N(3)). The foreign tax imposed on the dividends does not qualify for a section 6*quat* or section 6*quin* rebate as both these sections require that an amount be included in the taxpayer's taxable income. Therefore because the dividend received from the foreign company is income from a listed share it is exempt from tax, i.e. it is not included in the taxpayer's taxable income and the sections do not apply. However, in the case where a foreign dividend qualifies for a partial exemption in terms of section 10B(3) of the Income Tax Act, only a portion of the dividend is exempted as discussed above. Therefore, not all the income from a listed share is exempt from tax. The portion that is not exempt may qualify for a section 6*quat* or section 6*quin* rebate as this portion is included in taxable income.

In terms of the provisions of Article 10 of the SA/DRC DTA South African residents deriving dividend income from the DRC may be taxed in both South Africa and the DRC. However, the DRC may tax such income at reduced tax rates. This, however, does not apply where the recipient of the dividends has a permanent establishment in the DRC and the dividends are declared by the permanent establishment.

As explained above, South Africa will not tax dividends received by residents in the cases provided for in section 10B(2). This therefore means that no double taxation arises in such cases. In instances where only a portion of the dividend income was exempt, section 6*quat* is available for the taxpayer to alleviate double taxation on the part of the dividend included in taxable income. Double taxation may also be eliminated in terms of Article 21 of the DTA. Where the dividends are derived from a DRC company listed on the JSE then section 64N as provided above would apply.

4.3.4 Interest

Foreign interest received by South African residents is fully taxable in South Africa. This means that foreign interest could potentially be subject to double taxation. Section 9(2)(b) of the Income Tax Act provides that the source of interest income is South Africa when such income is attributable to an amount incurred by a South African resident or the income is used or applied in South Africa. Where the interest income is attributable to the resident's permanent establishment situated outside South Africa section 9(2)(b)(i) provides that the income is not from a South African source. Therefore any interest that does not fall into the abovementioned provisions is from a source outside South Africa (Haupt: 2013).

According to the provisions of Article 11 of the DTA, interest earned by a South African resident from a resident of the DRC may be taxed in South Africa as well as the DRC (at a reduced rate in the DRC). The taxpayer is then relieved from double taxation in terms of Article 21 of the DTA or section 6*quat*. Section 6*quat* is available to the taxpayer in this case regardless of where the interest is used. This is because paragraph 6 of Article 11 of the DTA provides that the source of interest income is where the payer of the interest is resident. Therefore, where a DRC resident pays interest to a South African resident the source is the DRC.

It should be noted that the above provisions do not apply where the recipient of the interest income has a permanent establishment in the DRC and the interest is paid by the permanent establishment.

4.3.5 Royalties

Just as is the case with foreign interest income, foreign royalties may be fully taxable in South Africa. This means that royalties could potentially be subject to double taxation. Section 9(2) provides that the source of royalties is in South Africa if the royalty is incurred by a South African resident or it is received or accrues in respect of the use or right of use in South Africa of intellectual property as defined. However, with regard to royalties earned by South African and DRC residents from each other, paragraph 5 of Article 12 provides that the source of royalties is the country in which the payer of the royalties is resident.

According to the provisions of Article 12 of the DTA, royalties derived by a South African resident from the DRC may be taxed in South Africa as well as in the DRC (taxed at a reduced rate in the DRC). The taxpayer is then granted relief in terms of Article 21 of the DTA or section 6*quat*. As previously stated, the rebate in terms of section 6*quat* is available to the resident as the royalties are derived from a foreign source as determined in terms of paragraph 5 of Article 12.

Where the recipient of the royalties has a permanent establishment in the DRC and the royalties are borne by the permanent establishment then the royalties will be dealt with under the business profits article in the DTA.

4.3.6 Capital gains

Although foreign capital gains are taxable in South Africa, only 33.3 per cent in the case of natural persons and 66.6 per cent in the case of juristic persons is included in taxable income. Therefore only 33.3 or 66.6 per cent of a resident's foreign capital gain may potentially be subject to double taxation.

Furthermore, paragraph 64B of the Eighth Schedule to the Income Tax Act provides that any capital gain from the disposal of equity shares in a foreign company must be disregarded in certain circumstances. However, this does not apply where the value of the shares of the foreign company is mainly derived from immovable property in South Africa. The following requirements have to be met before a capital gain is disregarded in terms of paragraph 64B:

- the resident must have held at 10 per cent of the equity shares and voting rights in the foreign company;
- the shares must have been held by the resident for at least 18 months before the disposal unless the person disposing the shares is a company and the interest was acquired from any other company that forms part of the same group of companies and the person selling the shares together with the other company held the interest for more than 18 months; and
- the interest is disposed of to a non-resident (other than a controlled foreign company) for an amount that is equal to or exceeds the market value of the interest.

Section 9(2)(j) of the Income Tax Act provides that the source of a capital gain is South Africa where the gain is derived from the sale of immovable property located in South Africa. In the case of any other asset, section 9(2)(k) provides that the source of such gain is South Africa if the gain is derived by a resident and the asset is not attributable to a permanent establishment of the resident situated in another country and the proceeds from the disposal are not subject to a foreign tax.

As provided by Article 13 of the SA/DRC DTA, where a South African resident derives a capital gain from the disposal of immovable property situated in the DRC such gain may be taxed in the DRC and the gain may also be taxed in South Africa. As this qualifies as a foreign capital gain in terms of the South African source rules and a rebate in terms of section 6*quat* is available to the taxpayer. However, since only a portion of a capital gain is taxable in South Africa, the rebate granted in terms of section 6*quat* is subject to a number of limitations (SARS: 2009). Firstly, to determine the foreign tax payable on the taxable capital gain, the amount of the capital gain which is subject to the foreign tax is compared to the amount subject to South African tax; this is done using the formula provided in Interpretation Note 18 (SARS: 2009):

$$\frac{amount\ of\ foreign\ taxable\ capital\ gain\ included\ in\ taxable\ income}{amount\ of\ foreign\ taxable\ capital\ gain\ subject\ to\ foreign\ taxes}\ x\ foreign\ tax\ payable$$

The formula above determines the portion of the foreign tax liability that relates to the foreign taxable capital gain. Once the amount of foreign tax attributable to each taxable capital gain is calculated, all the taxes on foreign capital gains are added together. The aggregate amount of foreign tax is limited to the amount of South African tax attributable to

the aggregate foreign capital gains; this is calculated in terms of the formula provided in Interpretation Note 18 (SARS: 2009):

$$\frac{amount\ of\ foreign\ taxable\ capital\ gains\ included\ in\ taxable\ income}{total\ taxable\ income\ from\ all\ sources}\ x\ normal\ tax\ payable$$

Alternatively, the taxpayer may be granted relief in terms of Article 21 of the DTA.

Where a South African resident derives capital gains from the disposal of movable property that forms part of a permanent establishment of the resident in the DRC, then the DTA grants both South Africa and the DRC the right to tax such gains. Relief is provided in terms of Article 21 of the DTA or in terms section 6*quat* as provided above.

Capital gains derived by an enterprise from the alienation of transport vehicles operated in international traffic are only taxable in the enterprise's country of residence, as stated in paragraph 3 of Article 13 of the SA/DRC DTA. Exclusive taxing rights are granted in the seller's place of residence in any other case not expressly provided for in Article 13 of the DTA. No double taxation arises in such cases.

4.3.7 Income from employment

The originating cause of income from employment is the services rendered for which the remuneration is paid and the source of such remuneration is therefore located in the country where the service is rendered (Van Schalkwyk: 2012).

Income earned by South African residents from employment outside South Africa is subject to income tax (Haupt: 2013). However, section 10(1)(o) of the Income Tax Act provides an exemption in the case of remuneration derived by an officer or crew member of a ship engaged in the international transportation of passengers or goods, if such person is outside South Africa for periods exceeding 183 days during the year of assessment. Remuneration derived by any person in respect of services rendered outside South Africa on behalf of any employer is exempt if such person was outside the South Africa for periods more than 183 days during any 12 month period beginning or ending during the year of assessment and for a continuous period exceeding 60 days during the 12 month period (Haupt: 2013).

Article 14 of the SA/DRC DTA provides that employment income earned by South African residents should only be taxed in South Africa unless the employment is actually exercised in

the DRC. Where employment is exercised in the DRC, the DTA provides that both countries may tax the income. However, the DRC loses the right to tax the income if:

- the South African resident is only in the DRC for periods less than 183 days in any 12-month period beginning or ending in the year of assessment;
- the employment income is paid by a non-resident of the DRC; and
- the employment income is not borne by the employer's permanent establishment situated in the DRC.

The effect of this is that where employment income is taxable in the DRC it will be exempt in South Africa in terms of section 10(1)(o), should all the requirements of section 10(1)(o) be met.

4.3.8 Directors' fees

Williams (2006) states that a director renders his or her services at the head office of the company as this is where the board of directors manages the business. The source of directors' fees is therefore where the head office of the company is located.

As discussed in the previous chapter, according to Article 15 of the SA/DRC DTA, fees paid to a South African resident who is a director of a Congolese company may be taxed in the DRC. As the Article provides that such fees "may be taxed" in the DRC, this implies that South Africa may also tax the income.

The double taxation arising in this regard is eliminated through the application of section 6*quat* as the fees are from a foreign source, in other words, the head office of the company in the DRC. Alternatively, relief is also provided in terms of Article 21 of the DTA.

4.3.9 Income from government services

Section 9(2)(h) provides that income is from a South African source when it is received by a South African resident in respect of services rendered to or on behalf of any employer-

- in the national, provincial or local sphere of the South African government;
- that is a constitutional institution listed in Schedule 1 to the Public Finance Management Act No. 1 of 1999;
- that is a public entity listed in Schedule 2 or 3 to that Act; or

- that is a municipal entity as defined in section 1 of the Local Government Systems Act No. 32 of 2000.

According to the provisions of Article 18 of the SA/DRC DTA, income earned by an individual from services rendered to a government or other authority of a country should only be taxed in that country. Therefore services rendered by a South African resident to the DRC government are only taxable in the DRC. However, if the services are rendered in South Africa by a South African resident who is also a South African national or did not become a South African resident only for the purposes of rendering the services, then the income is only taxable in South Africa. As a result of the exclusive allocation of taxing rights double taxation does not arise.

4.3.10 Other Income

As mentioned previously, section 9 of the Income Tax Act provides the source of different classes of income. Where any class of income is not provided for in section 9, the source is determined in terms of case law principles. Identifying the source of the income is important in order to determine whether the section 6*quat* rebate can be applied in order to relieve the taxpayer of any double taxation that may arise.

In terms of the provisions of Article 20 of the SA/DRC DTA, where a South African resident derives any type of income not provided for in any of the Articles of the DTA, such income is taxable only in South Africa, wherever it may arise. However, the Article continues to state that where the income arises in the DRC, then the DRC may also tax the income. As in the case with the other categories of income provided above, double taxation relief in such instance is granted in terms of Article 21 of the DTA or section 6*quat* of the Income Tax Act.

4.4 CONCLUSION

Countries enter into DTAs to encourage foreign direct investment flows. DTAs play a role in facilitating foreign direct investment flows by eliminating double taxation, providing investors with a degree of certainty with regard to the taxation of various investments and reducing withholding taxes. DTAs also ensure that investors involved in cross-border investment are not burdened with any extra taxes simply because they are not nationals of a particular State. By means of certain provisions of a DTA, countries are also provided with improved revenue collection abilities as well as mechanisms to negotiate and resolve disputes.

For South African residents the SA/DRC DTA allocates the taxing rights of various items of income earned by such residents from the DRC. In a number of cases both South Africa and the DRC are granted the right to tax the same item of income. Article 21 of the DTA, however, grants the taxpayer relief. The South African resident is further granted tax relief in terms of rebates provided for in sections 6*quat*, 6*quin* and 64N, as well as exemptions provided for in the Income Tax Act. Double taxation relief under Article 21 of the DTA is subject to the provisions of section 6*quat* which therefore means that relief is essentially provided for only in terms of section 6*quat*.

Through the application of section 6*quat*, double taxation relief is granted for South African residents. Where the requirements of section 6*quat* are not met then section 6*quin* may provide the taxpayer with relief. Furthermore in the case where the provisions of the DTA are incorrectly applied, the DTA provides mechanisms by which the dispute can be resolved. It is therefore evident that the DTA and the unilateral measures provided in the Income Tax Act provide double taxation relief for South African residents earning income from the DRC, although foreign tax credits may remain unused under certain circumstances.

This chapter has demonstrated that all forms of income earned by South African residents in the DRC will qualify for some form of tax relief, whether it is in terms of unilateral relief such as exemptions or rebates, or in terms of the SA/DRC DTA.

The following chapter will conclude the research by discussing the findings in the chapters, drawing attention specifically to the goals of the research provided in Chapter 1.

CHAPTER 5

CONCLUSION

5.1 INTRODUCTION

The previous chapters of the research demonstrated that South African residents earning income from the DRC may be subject to double taxation as a result of the residence-source conflict that may occur. The South African Income Tax Act provides mechanisms to eliminate such double taxation in the form of exemptions and rebates. Furthermore, relief is also provided under the SA/DRC DTA, which allocates taxing rights between the two countries. Although the preamble to the DTA provides that the DTA is entered into to avoid double taxation and prevent tax evasion, it is submitted that the agreement also provides other benefits to both taxpayers and the countries that are party to the agreement. It was further concluded that the various classes of income that could be earned by South African residents in the DRC will qualify for some form of tax relief, whether in terms of the mechanisms in the Income Tax Act or under the provisions of the SA/DRC DTA.

The present chapter will provide a summary of the conclusions reached in the previous chapters of the research in order to demonstrate how the goals of the research stated in Chapter 1 have been addressed.

5.2 GOALS OF THE RESEARCH

The research aimed to identify the tax saving opportunities provided to South African residents by the SA/DRC DTA and to determine whether the double taxation relief provided in terms of the DTA, together with unilateral measures in the Income Tax Act, effectively prevent the double taxation of South African residents. To respond to the research question it was necessary to:

- discuss the unilateral measures in South African legislation designed to avoid double taxation;
- analyse the SA/DRC DTA;
- set out the benefits provided by the DTA to South African residents; and
- determine whether the unilateral measures in the Income Tax Act and the DTA provide double taxation relief in respect of all classes of income earned by South African residents from the DRC.

In chapter 2 the first goal of the research was addressed by way of a discussion of the unilateral measures provided for in the Income Tax Act for avoiding double taxation. These measures are intended to resolve conflicts arising from the concepts of source and residence in South Africa and any other country. The discussion indicated that sections 10, 6*quat*, 6*quin* and 64N of the Income Tax Act are intended to eliminate the double taxation of South African residents. Section 10 provides the exemptions from taxation of certain items of income derived by South African residents from foreign countries. The exemptions relevant to South African residents earning foreign-sourced income are as follows:

- Section 10B – grants the residents an exemption or partial exemption of foreign dividends.
- Section 10(1)(gC)(i) – grants residents exemption for amounts received under the social security system of a foreign country.
- Section 10(1)(gC)(ii) – exempts any pension derived from a foreign source for past employment outside South Africa.
- Section 10(1)(o)(ii) – exempts from taxation remuneration earned in respect of employment services rendered outside South Africa.

Foreign taxes paid by a resident on foreign-sourced income that are not exempted under the sections referred to above may qualify for a rebate in terms of section 6*quat*. This rebate is available when the resident:

- has paid or is required to pay foreign taxes on foreign-sourced income;
- has the legal liability to pay the taxes; and
- the foreign income is included in the resident's taxable income.

As the rebate is only available on income earned when a taxpayer is liable for tax on foreign-sourced income it is important to determine the source of the income. Although the Income Tax Act does not define the term, the source of different classes of income is set out in section 9. Where an item of income is not provided for in section 9, principles established in case law are applied to determine the source. In the case where the section 6*quat* rebate cannot be granted to a taxpayer because the income earned by the taxpayer is from a South African source, relief may be granted in terms of section 6*quin*. Section 6*quin* grants the taxpayer a rebate where a foreign tax is paid on income for services provided in South Africa. The section 6*quin* rebate is available when:

- foreign taxes are withheld in the foreign country;
- the income is included in the taxpayer's taxable income; and
- the taxpayer submits a return within 60 days from the date the tax was withheld.

Where the income is from a South African source the taxpayer may also choose to deduct the foreign taxes withheld in terms of section 6*quat*(1C) instead of claiming the section 6*quin* rebate. A section 6*quat*(1C) deduction is only available when the taxpayer is carrying on a trade.

Chapter 3 analysed the SA/DRC DTA by comparing it to the OECD MTC. The chapter concluded that the DTA closely follows the provisions of the MTC and that double taxation is eliminated through the allocation of taxing rights between the two countries as well as the application of the credit method, in the case of South African residents. Taxing rights are either exclusively granted to South Africa or the DRC, whilst in certain cases both countries may tax particular classes of income. The analysis revealed that the application of the credit method to eliminate the double taxation of South African residents as provided for in the DTA is achieved in South Africa through the provisions of section 6*quat*.

In chapter 4 of the research the benefits of the DTA were set out. The chapter concluded that DTAs may play a role in facilitating foreign direct investment flows, which is an important reason why countries enter into such agreements. Although the impact DTAs have on foreign direct investment is subject to debate, it is submitted that DTAs do contribute to an improved investment climate for investors. This climate is created through the elimination of double taxation. Furthermore, DTAs create an improved investment climate as they provide certainty with regard to the tax treatment of different classes of income. This is because DTAs detail the tax treatment of various types of income and the provisions of a DTA have a degree of permanence. Therefore, investors are not only certain of the tax implications of their various investments but are able to plan for the future. DTAs also grant investors reduced withholding taxes and ensure that taxpayers investing in foreign countries are treated with the same degree of fairness as the nationals of the country in which they are investing. It is submitted that this motivates investors to engage in cross border trade and investment activities.

South African taxpayers earning income from the DRC have the option to elect relief under the Income Tax Act or in terms of the DTA. As relief under the DTA is subject to the

provisions of section 6*quat*, the chapter concludes that relief for such residents is in practice only available in terms of section 6*quat*. Although this is the case the chapter demonstrates that double taxation relief is available for South African residents earning all types of income from the DRC.

5.3 CONCLUSION

The DTA entered into between South Africa and the DRC is one of the many mechanisms aimed at increasing trade and investment between the two countries. With the DRC imposing tax on income derived from a source within its borders and South African residents paying tax on their worldwide income, South African residents earning income from the DRC may be subject to taxation in both countries. Double taxation relief is thus available in terms of the SA/DRC DTA, which allocates the taxing rights in relation to different items of income between South Africa and the DRC. Such rights are allocated in such a way that certain items of income are exclusively taxable in South Africa for example, business profits which according to Article 7 of the DTA are only taxable in South Africa unless such profits relate to a permanent establishment situated in the DRC. The exclusive right to tax income in some instances is also granted to the source country, the DRC for example, where the South African resident earns employment income in the DRC.

In many cases, the DTA allocates to both countries the right to tax income and provides for the elimination of double taxation in terms of the credit method. This method requires the resident country, which is South Africa, to grant a credit against the taxpayer's tax liability in respect of the taxes paid in the DRC. According to Article 21 of the DTA this credit is to be determined in terms of the provisions of section 6*quat* of the Income Tax Act.

Furthermore, double taxation relief is also provided in various sections of the Income Tax Act, which exempt foreign income from taxable income, grant a credit against the taxpayers' tax liability in respect of foreign taxes paid or provide for a deduction from income any foreign tax payable on income that is from a South African source. Therefore, a resident may choose relief in terms of the sections in the Income Tax Act or in terms of the DTA. As relief under the DTA is subject to the provisions of section 6*quat* it is submitted that relief in terms of section 6*quat* is in practice the only form of relief available for residents. Although this is the case, it is submitted further that the relief granted unilaterally in the Income Tax Act together with the provisions of the DTA will grant double taxation relief for all types of income earned by South African residents from the DRC.

To contribute to the positive growth of cross border trade and investment DTAs create a stable investment environment. Therefore, it is concluded that the SA/DRC DTA will promote investment in the DRC, strengthening the trade relationship between South Africa and the DRC.

The present research focused on the tax implications of the SA/DRC DTA on South African residents. To add on to the present research a study on the tax implications of the DTA on the DRC and its residents may be conducted. This is to determine whether the positive contribution made by the DTA to investments in the DRC compensates for the loss of tax income as a result of reduced withholding taxes as well as reduced taxing rights.

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