# A technical analysis of the difference in treatment of technical fees in relation to the receipt of management fees by a resident of South Africa, sourced from Botswana and Zambia, including the impact of domestic and treaty relief.

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**Abstract**

With international developments there has over the past few years been an increase in the provision of cross border services. By nature, services are often intangible and can in most cases be provided remotely. As such, an individual or enterprise providing personal services can substantially be involved in another state's economy without establishing a permanent establishment or fixed base.

This phenomenon proved problematic, especially in developing countries who are large importers of services, in that the country paying for the services would not be in a position to tax these activities however would, in terms of application of their domestic laws, be required to provide a deduction in relation to the payment for services where it relates to legitimate costs incurred in the production of income. In light of this, and in an attempt to protect their tax base, it is found that majority of developing countries would incorporate in domestic law a tax on technical services paid to non-residents. This is usually in the form of a withholding tax.

This practice was undesirable for both taxpayers and tax authorities in that it resulted in unrelieved double taxation or double non-taxation which in turn causes difficult disputes whilst consuming scarce resources. In light of this, a new Article 12A- *Fees on technical services* had been drafted into the 2017 United Nation Double Taxation Convention between Developed and Developing Countries (the "UN Model"). This article provides a Source State to tax certain technical services defined as "any payment in consideration for any service of a managerial, technical or consultancy nature, at a rate agreed between the two States, on a gross basis".

By performing qualitative research, based on a simplistic scenario for management fees, it is found that the inclusion in a treaty of an article similar to Article 12A makes the application of treaty relief easier and neutralises the tax effect for a South African resident. However, where no distributive rules to technical services (in particular management fees) apply in a treaty it may become burdensome to prove that treaty relief should apply in a case where double taxation occurs.

Based on the results of the research (due to the economic impact it may have on South Africa), it is recommended that South African treaties with other developing countries which levy a withholding tax on management fees, should be updated by protocol or renegotiation of the treaty to include a similar article to the new Article 12A in the UN Model.

## CHAPTER 1: INTRODUCTION

### 1.1. Background and Objectives

***History***

"One of the functions of corporate tax has been described as collecting tax from the income earned domestically. In describing this function, it may be considered to be flawed in that the tax base of an enterprise or individual is mobile and can be manipulated".[1]

"The manipulation of a tax base can occur through a number of methods, one of them being the payment of service fees".[2] In this regard, an opportunity exists for multinational enterprises ("MNE's") to shift profits between companies within the group which may be subject to lower tax rates, through the payment of amounts classified as service fees.

In light of this, issues on the taxation of income from technical, managerial, consultancy and other similar services ('technical services') have been a key concern and agenda point of the UN Committee of Experts on International Cooperation in Tax Matters ("the Committee")[3] for a number of years.[4] During 2012 the majority of the members of the Committee had voted for the inclusion of an article on technical services which has now been drafted into the 2017 United Nation Double Taxation Convention between Developed and Developing Countries ("the UN Model").

Prior to the introduction of Article 12A- *Fees on technical services*, in terms of Model treaty provisions, "income from services derived by an enterprise of a Contracting State was taxable exclusively by the State in which the enterprise was resident unless the enterprise carried on business through a permanent establishment ("PE") in the Other State or provided professional or independent personal services through a fixed base in that Other State".[5] As is in the current OECD Model and previous UN Model, this is based on the understanding that income should be attributed to the State in which the production factors for income generation are located rather than where the goods are sold or where the services are rendered (i.e. where the consumer market is).

The OECD Model had previously included Article 14 - *Independent personal services* to which technical services may have applied. However, based on the approach which allows taxing rights on a certain type of income only where a sufficient economic nexus exists between the taxpayer (or the income as such) and the Other State[6], the article was excluded from the OECD Model (1997 version) on 29 April 2000. This on the basis that there is no distinction between the distribution of taxing rights on personal services, through a fixed base, as is the case in Article 14, to that of business profits per

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[1] Smit, G. 2015. Withholding tax on service fees as a method to combat base erosion and profit shifting. MCom Thesis. North West University, (accessed 1 October 2018) Available online: http://repository.nwu.ac.za/bitstream/handle/10394/21318/Smit_G_2015.pdf?sequence=1.

[2] Smit, G. 2015.

[3] A subsidiary body of the Economic and Social Council which is responsible for keeping under review and update, as necessary, the UN Model and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

[4] Orzechowski, D. 2017. The taxation of fees for the technical, managerial and consultancy services in the digital economy with respect to Art.12A of the 2017 UN Model. *Committee of Experts on International Cooperation in Tax Matters.* Fifteenth Session: page 2, (accessed 23 September 2018). Available online: http://www.un.org/esa/ffd/wp-content/uploads/2017/10/15STM_CRP23_Technical-Services.pdf.

[5] Para.2 UN Model: Commentary on Art.12A, page 322.

[6] Orzechowski, 2017, page 20.

Article 7. It is however believed that Article 14 was initially included in the OECD Model in order for a Resident State to more easily identify whether non-residents create a taxable presence in the country which may otherwise have been difficult to identify.

Despite this change, there remain some deviations from Resident State taxation and the PE concept in both the OECD and UN Models. These exceptions are however limited to certain types of services/income. "For example, under Article 8 (alternative A), income from international transport is taxable exclusively by the State in which the place of effective management of the enterprise is located; under Article 8 (alternative B), the source country is entitled to tax income from the operations of ships in international traffic if the operations in that country are more than casual". [7]

Exceptions are also found in Articles 16 and 17. "Under Article 16, a Contracting State is entitled to tax directors' fees and the remuneration of top-level managerial officials derived by residents of the other State if the fees or remuneration are derived by those residents in their capacity as directors or officials of companies resident in the first State. In this case, the State in which the company paying the fees or remuneration is resident is entitled to tax irrespective of whether the services are performed inside or outside that State. Under Article 17, a Contracting State is permitted to tax income from the activities of an artiste or sportsperson if the activities take place in that State. No permanent establishment or fixed base is necessary. Nor is it necessary for the artiste or sportsperson to be present in the source State for a certain minimum amount of time".[8]

Articles 10, 11 and 12 of both the UN and OECD Models provide the Source State the right to withhold a certain percentage of the gross amount of any distributed dividends, interest or royalties to a resident of one of the Contracting States.

The new Article 12A also deviates from this concept in that it allows the paying country to impose a withholding tax on payments by a resident/PE to the other state of the qualifying fees in the absence of the recipient having a PE in the paying state.[9]

***International developments***

Following international developments there has over the past few years been a significant increase in the provision of cross border services. "The Davis Tax Committee of South Africa conducted an investigation into tax base erosion and concluded that between 2008 and 2011 close to 50% of payments made to non-residents related to legal, accounting and management consulting fees".[10]

By nature, services are often intangible and can in most cases be provided remotely. In this regard, an individual or enterprise providing personal services can substantially be involved in another state's economy without establishing a PE or fixed base. This is particularly detrimental to developing countries which, due to a list of various challenges faced (e.g. the lack of education), are generally found to be net importers of technical services. Hence, excluding Article 12A, the importing country

[7] Revised draft Article and Commentary United Nations Model Tax Convention: *Article XX - Fees for technical and Other Services*. Committee of Experts on International Cooperation in Tax Matter. Tenth Session (2015): Para. 3, page 3, (accessed 23 September 2018). Available online: http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP.5_Services.pdf

[8] Article XX - Fees for technical and Other Services, para.4, page 3.

[9] UN Model Double Taxation Convention between Developed and Developing Countries: Commentary on Article 12A (2017), Models IBFD, para.1, page 318.

[10] Smit, G. 2015.

(i.e. the Source State[11]) may not have any taxing rights on the services being provided in the country (as there is no fixed base) however in most cases would be required to provide residents with a deduction for expenses incurred in receiving those service as these relate to legitimate costs incurred in the production of income. It is thus evident that the lack of source taxing rules may essentially lead to a decrease in a country's tax base.

In addition, according to UN Model Commentary, the inability of countries to tax fees for technical services provided by non-residents may give non-resident service providers, in certain circumstances, a tax advantage over domestic service providers. "For example, fees by domestic providers may be subject to domestic tax at ordinary rates applicable to business profits whereas as non-residents who do not have a PE or fixed based in that state may only be subject to lower taxes in their country of residence".[12] This may provide the opportunity to non-resident service providers to quote lower fees compared to domestic providers. This may in effect be problematic in that inequity is created.

The uncertainty concerning the treatment of fees for technical and other similar services under the provisions of the UN Model, as it read before 2017, was undesirable for both taxpayers and tax authorities. "It may also have resulted in difficult disputes, both for taxpayers and administrations, consuming scarce resources, as well as causing unrelieved double taxation or double non-taxation".[13]

This goes against the aim of bilateral tax treaties "to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on".[14] In this regard, the main basis for specific inclusion of Article 12A into the UN Model 2017 by the Committee of Experts was thus to "strengthen the preservation of Source State[15] rights with the aim of a "fair" allocation of taxing rights between residence and source states and prevention of base erosion of the tax base in the Source State originating from the deductibility of expenses for fees for technical services".[16]As noted in the UN commentary "if the country is entitled to tax the non-resident service provider on the fees earned for the technical services, the reduction of the country's base by the deductible payments is offset by the country's tax on those fees".[17]

The article as included in the UN Model does not establish any threshold for the taxation of fees of a technical, managerial and consultancy services nature and taxing rights are established in the Source State irrespective of where the services are provided.

It has been noted that from a practical point of view, it is thus a feasible and desirable solution[18] which is in line with the general practice of the United Nations Model to favour the retention of the greater so called "source country" taxing rights.[19] Per Article 12A the source of technical services is deemed to be the State in which the payor is resident.

[11] In terms of Article 12A, the source of technical fees is deemed to be the state in which the payor is resident.
[12] Para.11 UN Model: Commentary on Art. 12A, page 322.
[13] Para.6 UN Model: Commentary on Art. 12A, page 320.
[14] Para.6, Introduction to UN Model, 2017, page iv.
[15] Source country taxing rights under a tax treaty refers to the taxation rights of the host country of investment as compared to the residence country of the investor.
[16] Orzechowski, 2017.
[17] Para.7 UN Model: Commentary on Art. 12A, page 320.
[18] Orzechowski, 2017, page 22.
[19] Para. 3: Introduction to UN Model, page iii.

***South African current domestic and treaty practice***

"In terms of the 2013 Taxation Laws Amendment Act (31 of 2013) sections 51A to 51H (withholding tax on service fees) was inserted in the South African Income Tax Act, No. 58 of 1962 ("ITA- SA").

In terms of this assented legislation, a tax of 15% was proposed on services paid by a person to a non-resident. This withholding tax would apply to the extent that the amount was from a source within South Africa. National Treasury indicated that the legislation was not developed with an intention to create another source of revenue but rather to identify non-resident taxpayers and to gather information on these taxpayers".[20] According to National Treasury, the South African Revenue Services ("SARS") was struggling with the gathering of information to identify PE's of non-residents as they do not file their required tax returns and thus completely avoid South African tax.

In her thesis, G Smit explored the impact of the enactment of a withholding tax in South Africa and whether it was in line with the intention of the National Treasury. In her analyses she notes that "*the imposition of a withholding tax may result in a reduction of foreign investments in South Africa, especially from developed countries. South Africa has been described as a preferred gateway for investors looking to expand their operations into Africa. These multinational operations usually require managerial services and the imposition of an additional tax on the payment for these services may further reduce foreign direct investments. With the legislation, South Africa could be perceived as moving against international norms. This in turn may lead to less investment in and the reduced use of South Africa as a trading position*".[21]

In conclusion, G Smit recommended that "SARS could utilise the South African Reserve Banks' authorised dealers to report the information when a payment of services to a non-resident is made. Alternatively, legislation could be implemented which requires the resident who is making the payment to report the required information to SARS".[22]

In this regard, proposed legislation on the taxation of "service fees", which included fees for technical, managerial and consultancy services, was repealed by January 1, 2017. Instead of legislation on the taxation of non-resident service providers for 'service fees', South Africa introduced reporting obligations on arrangements for the rendering of specific services.

"An obligation to report a service arrangement to South African revenue authorities arises, if a non-resident service provider is physically present in South Africa for the purpose of rendering services of consultancy, construction, engineering, installation, logistical, managerial, supervisory, technical or training nature. However, those kind of service arrangements are only reportable, if the fees are anticipated to exceed ZAR 10 million in aggregate. In case that the parties to the arrangement fail to stick to the reporting obligation, a penalty may be fined to both contracting parties."[23]

*Interactions with other African countries*

In practice however, in an attempt to protect their tax base, numerous other developing countries had incorporated in domestic law, a tax on technical services paid to non-residents on a gross basis.

[20] Smit, G. 2015.
[21] Smit, G. 2015.
[22] Smit, G. 2015.
[23] Orzechowski, 2017, para. 46, page 16.

Due to administration capacity constraints of tax authorities in application of domestic or international anti-avoidance rules it is easier to create a withholding or reporting obligation on a resident for activities/services provided in country by non-residents. As demonstrated in Appendix A, 46 of 48 African countries had, as at September 2018, included a withholding tax on either technical or specifically management fees. These efforts however may be futile in a case where a treaty exists with another Contracting State where there is no reference to source tax rules on technical services, in which the treaty provisions would override the Source State's domestic law.

***Inclusion of Article 12 A in the UN Model***

As noted in the UN commentary, there continues to remain concern and a difference in opinion as to the inclusion of Article 12A in the UN Model. In 2007 the Committee noted that "if source taxation of income derived from technical services performed in a state is considered to be appropriate, it should be done through an extension of the permanent establishment concept so as to make the rules of Article 7 applicable rather than through the inclusion in double taxation conventions of a technical fees article".[24]

Based on the nature of technical fees it may somewhat fall within other distributive articles of the OECD and UN Model, including but not limited to taxing provisions for professional and other independent services covered by the scope of Article 14, the taxation of business profits per Article 7 or in some instances Article 12. This however will depend on the circumstances in each case and the interpretation of the articles of the Models and specific treaty provisions.

In this regard, where no other treaty provision exists which allows taxing rights to the Source State, only the Resident State of the person/entity receiving the income may be allowed to tax. As such, treaty benefits may potentially not apply and double juridical tax could remain.

For a South African resident, domestic relief for double taxation largely depends on the "source" of income. In terms of domestic law, there is no universal definition or understanding of the meaning of source nor does the Act define the term. In application of South African case law, it is however an established principle that the source of income from services rendered is not dependent on where the service contract is signed or where payment is made, but rather where the service is rendered. A rebate from tax payable in terms of section 6quat(1A) is allowed where the income so taxed is considered foreign sourced income. On the other hand, only a deduction is allowed from taxable income in terms of section 6quat(1C) where the income so taxed is considered local sourced income.

In this regard, although South Africa does not levy a withholding tax on services, South African residents, in particular, may be subject to double juridical tax where services are provided to other developing countries.

Using illustrative examples, the objective of this paper is to analyse whether there is a difference in the tax on technical fees (specifically management fees) in relation to a South African treaty which has an article similar to the new Article 12A compared to one which does not. Based on the facts considered it will also be considered on a high level as to whether the inclusion of Article 12A is in

[24] Moreno, A.B. 2015. *The Taxation of Technical Services under the United Nations Model Double Taxation Convention: A Rushed – Yet Appropriate – Proposal for (Developing) Countries?* World Tax Journal. 7(3), introduction and scope, (accessed 23 September 2018). Available online: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/wtj_2015_03_int_2.pdf.

line with the general objective of bilateral tax treaties to protect a taxpayer against double juridical taxation.

### 1.2. Research Method

This paper applies a doctrinal research method to address and conclude on the research question. This has been carried out in the form of a case study in which an example is used in two situations to analyse the taxing rights on technical services, in particular, management fees.

The analysis will primarily be focused on the bilateral treaties between South Africa and Botswana and between South Africa and Zambia. This selection is based on the large amounts of exports from South Africa to these African countries as illustrated through a bubble graph in Appendix B.[25] As illustrated, between January and August 2018, the 5 highest African countries to which South Africa had exported goods included Botswana, Namibia, Mozambique, Zambia and Zimbabwe. Of a total of R 212,924,811,105 in exports to other African countries, South Africa had exported R 33,289,945,180 to Botswana and R 20,548,774,228 to Zambia, equating to 15.63% and 9.65% respectively.[26]

Furthermore, Botswana has been selected based on the inclusion of Article 20- *Technical fees* in the bilateral treaty with South Africa. Zambia is thus selected as the treaty with South Africa has no reference to a technical service article.

The analysis also draws on foreign legislation, specifically the Income Tax Act Chapter 52:01 of Botswana ("ITA- Botswana"), and the Income Tax Act Chapter 323 of the Laws of Zambia ("ITA- Zambia") including various OECD and UN publications, model treaties and their commentaries, and publications by various South African and international researchers.

Lastly, the analysis also draws on certain South African case law.

### 1.3. Research Question

The main research question is:
Does the inclusion of the technical service article in the South African- Botswana treaty have a different effect on the taxing rights of management fees compared to the South African- Zambia treaty and whether the inclusion of a similar article as Article 12A is in line with the general objective to protect a taxpayer against juridical double taxation?

Sub questions which will be addressed in answering the main research question are:
Could other treaty provisions be applied in taxing management fees which arise in a Source State per the respective treaties? and

What is the effect of treaty and domestic relief in relation to the potential double taxation?

[25] South African Trade Statistics between January and August 2018. *South African Revenue Services Tool,* (accessed 29 September 2018). Available online: http://tools.sars.gov.za/Tradestatsportal/Bubble_Chart1.aspx.
[26] South African Cumulative Bilateral Trade by Country between January and August 2018. *South Africa Revenue Services Tool,* (accessed 29 September 2018). Available online: http://www.sars.gov.za/ClientSegments/Customs-Excise/Trade-Statistics/Pages/Merchandise-Trade-Statistics.aspx.

## 1.4. Delimitations of Scope and Assumptions

The case study will not consider the nature of services which may or may not fall in the ambit/definition of technical fees and will focus only the receipt of management fees as specifically noted to be a technical fee in the UN Model.

In addition to the allocation of rights to the Resident and Source State countries of management fees, the UN model makes reference to the taxing rights on transfer pricing adjustments in relation to transactions between associated entities. This paper will not consider the taxing rights of any transfer pricing adjustments between the two parties.

Furthermore, in accordance with commentary on the UN Model, there are additional considerations where technical fees are considered to be re-imbursive for costs incurred for services provided. This paper will not consider management fees which are of a re-imbursive nature.

The analysis will be based on two treaties, being the Botswana- South Africa treaty and the Zambia-South Africa treaty. As such it will focus on the interaction between the two states and will not consider the taxing rights in relation to management fees being received in a third state.

## 1.5. Structure of the dissertation

This paper will present an example of management fees received by a resident in South Africa both from a company incorporated in Botswana and one in Zambia. It will follow to discuss the tax impact of management fees in relation to the respective treaties with South Africa. Based on the outcome of taxing effect, it will follow on to discuss any treaty relief which may be evident with the respective treaties. This is highlighted as follows:

*Chapter 1: Introduction*
This section provides background to the recent inclusion of Article 12A in the UN Model Treaty Convention. It highlights the challenges faced by developing countries which calls for the inclusion of the article. This section also outlines the research question for the study to be performed. Additionally, it highlights the areas not covered in this paper.

*Chapter 2: Research article*
This section forms the basis for the research paper in which the tax effect on management fees earned by a South African individual is analysed based on domestic and treaty provisions. In summary, based on an illustrative example, the tax effect on management fees received for services performed by Mr. Res, a South African resident, to both a Botswana and Zambian incorporated entity is analysed. The case study initially considers the tax effect of management fees received from Botswana taking into account South African and Botswana domestic law including resident domestic relief. It then considers the effect on tax following the South African- Botswana treaty which includes reference to a similar article as the new Article 12A- *Fees on technical services* as included in the 2017 UN Model. The case study then follows the same process in light of management fees received from Zambia. The South-Africa- Zambia treaty however does not include an article similar to Article 12A.

In this regard, the assessment is made as to whether there is a difference in tax treatment following the inclusion of the *Technical Service* Article in a treaty.

*Chapter 3: Conclusion*

This section includes a summary of the findings of the research. A conclusion is reached in this section and the research question is answered. In addition, recommendations based on the results of the research is made. Furthermore, additional research opportunities are highlighted in this section.

## CHAPTER 2: RESEARCH ARTICLE

### 2.1. Treatment of management fees as received from Botswana

#### 2.1.1. Abstract

The tax effect on management fees received by Mr. Res, a South African resident, for services performed to a Botswana incorporated entity is analysed. The case study considers the tax effect on the management fees received by taking into account South African and Botswana domestic law. Consideration is also then given to the potential South African domestic relief available to Mr. Res.

It further analyses the effect on the taxes given the South Africa- Botswana treaty which has a similar article to the new Article 12A- *Fees on technical services* as included in the 2017 United Nation Double Taxation Convention between Developed and Developing Countries ("the UN Model"). The said article allows Botswana (the source state) to impose a withholding tax on the payment of management fees[27] made to Mr. Res, a resident of South Africa, in the absence of Mr. Res having a permanent establishment ("PE") in South Africa.[28]

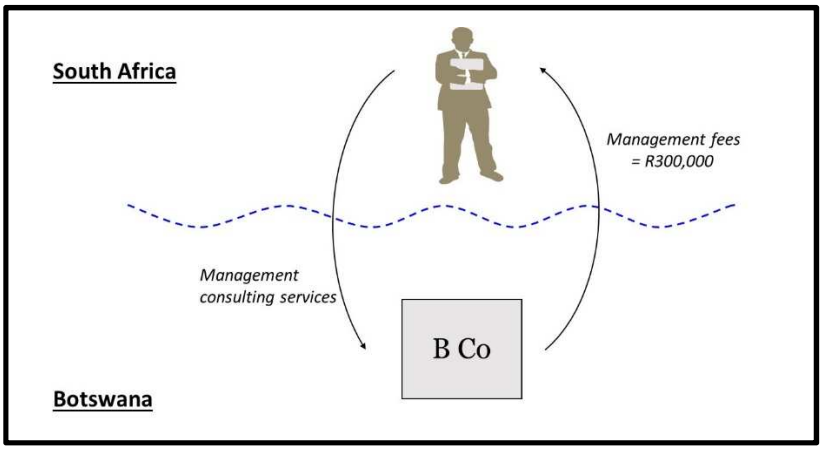
The analysis is performed through the application of an illustrative example.

#### 2.1.2. Illustrative example

The example used in the case study is with reference to the example used in the UN Model commentary on Article 12 paragraph 80 and is as follows:

Mr. Res, a resident of South Africa, is a management consultant who provides advice to companies concerning best practices for corporate governance. Mr. Res had entered into a contract in the current year of assessment to provide services to B Co, a public company incorporated and resident in Botswana, for a period of 60 days for fees of R5,000 per day. Mr. Res thus earned a total management fee of R300,000 from B Co.

This can be illustrated as follows:




[27] A technical service as defined in Article 12A(2)
[28] Para.2 UN Model: Art. 12A IBFD, page 23.

In analysing the tax effect on income earned by Mr. Res, the following domestic principles apply to each State:

### 2.1.3. Domestic tax principles of South Africa (Resident State)

i. In terms of the 'gross income' definition in section 1 of the Income Tax Act, No. 58 of 1962 ("ITA- SA"), "South Africa applies the worldwide system of income taxation in which resident companies and individuals are taxed on their worldwide income and non-resident companies are subject to tax on their South African-sourced income, which is not of a capital nature".[29]
ii. Section 1 of the ITA- SA defines a natural person to be "a resident if he/she is ordinarily resident in South Africa or physically present in South Africa for more than 91 days in the current tax year, physically present for an aggregate of more than 915 days in the preceding 5 tax years and physically present for more than 91 days in each of those preceding 5 tax years".[30]
iii. "The resident definition further defines a corporation to be a resident if it is incorporated or effectively managed in South Africa".[31]
iv. Corporate tax is levied at a standard rate of 28% and individuals are taxed with reference to a progressive tax table at a maximum rate of 45% where income is over R1.5 million.

### 2.1.4. Domestic tax principles of Botswana (Source State)

i. In terms of the definition of 'resident' in section 1 of the Income Tax Act Chapter 52:01 ("ITA- Botswana"), "an individual is resident if he is physically present in Botswana for 183 days or more in any tax year".[32]
ii. A company is resident in Botswana if it has its registered office or place of incorporation in Botswana; or it is managed and controlled from Botswana (section 2).
iii. The Botswana Unified Revenue Service (the "BRS") is responsible for the administration and collection of taxes.
iv. With regards to tax payable by B Co, in terms section 9 and through the definition of a 'person'[33] in section 2 of the ITA- Botswana companies pay tax on income from a source or deemed source within Botswana.[34] "Income tax is charged on the gross income (i.e. the total amount in cash or otherwise, excluding exempt income or any amount of a capital nature) of all companies and businesses which is received or accrued from sources within Botswana or from sources deemed to be in Botswana, less any allowable deductions (section 9)".[35] In determining taxable income, any expenditure which is wholly, exclusively and necessarily incurred in producing the income is deductible, subject to such evidence as the Commissioner General may require (section 39).

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[29] Hattingh. J. 2018. *South Africa – Corporate Taxation*, Country Analyses, IBFD, introduction, (accessed 23 September 18). Available online: https://online-ibfd-org.ezproxy.uct.ac.za/document/gtha_za_chaphead. And Income Tax Act, No.58 of 1962 of the Republic of South Africa, sec. 1, 'gross income'.
[30] Hattingh. J. 2018. *South Africa – Corporate Taxation* and Income Tax Act, No. 58 of 1962 of the Republic of South Africa, sec. 1, 'resident'.
[31] Income Tax Act, No. 58 of 1962 of the Republic of South Africa, sec. 1, 'resident'.
[32] Country Tables Comparison, IBFD.
[33] Includes an individual, a trustee, the estate of a deceased person, a company, whether incorporated or unincorporated, a partnership and every other juridical person.
[34] Income Tax Act Chapter 52:01 of Botswana, sec. 9.
[35] Amos. J. 2018. *Botswana – Corporate Taxation,* Country Analyses, IBFD, introduction (accessed 23 September 18). Available online: https://online-ibfd-org.ezproxy.uct.ac.za/document/gtha_bw_chaphead.

v. Resident companies are taxed on their income at a basic corporate tax rate of 22% with effect from 1 July 2011 (section 59 and Eighth Schedule of the ITA-Botswana). Special tax rates apply to companies engaged in manufacturing, mining and farming, as well as international financial services centre companies.

vi. Tax on certain categories of income derived by both resident and non-resident companies is levied by way of withholding at source, which may be final or creditable against the company's final tax liability.[36] "In accordance with sections 33(1) and (3) and 58(1) of the ITA- Botswana, a final tax on management or consultancy fees is payable by non-individuals and non-resident companies at a withholding tax rate of 15% on the gross amount".[37]

vii. In terms of section 2 of the ITA- Botswana, the term "management or consultancy fee" is defined to cover any amount payable for the development or customization of software; or administrative, managerial, technical or consultative services or similar services, whether or not such services are of a professional nature.

viii. Where a payment is made to a non-resident in the form of commercial royalties, management or consultancy fees, interest or entertainment fees, the amount (in relation to the payment made to the non-resident) is deductible only if the withholding tax in respect thereof has been deducted and paid to the BRS in that year.

As Mr. Res is a resident of South Africa, in terms of South African domestic law he will be taxed on the management fees earned from BCo as being part of his worldwide 'gross income'. For illustration purposes, it is assumed that Mr. Res will be subject to an effective South African domestic tax rate of 30% and that Mr. Res had not incurred any expenditure. In this regard, he will be liable for normal South African income tax payable of R90,000 (R300,000 x 30%).

Where Mr. Res provides his services in Botswana, he cannot be considered a resident of Botswana as he only provided his services to BCo for a period of 60 days.In terms of Botswana domestic law, a 15% withholding tax is payable by Co B on the payment made to Mr. Res on the basis that payment is made to a non-resident individual for technical fees. On the R300,000 income earned Mr. Res will only receive a net cash payment of R255,000 on the basis that R45,000 (R300,000 x 15%) will be required to be paid over by BCo to the BRS.

Mr. Res' overall income tax liability in terms of domestic income tax is illustrated as follows:

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| **Botswana** | | | |
| Management fee WhT | (@15%) | | R 45,000 |
| **Total tax payable** | | | **R 135,000** |
| **Effective tax** | | | **45%** |

[36] Amos. 2018, sec. 6.3.4.1.
[37] Amos. 2018, sec. 6.3.4.1.

On his income of R300,000, Mr. Res is subject to a total tax liability of R135,000 which is effectively 45% of his income. It is evident from the above that international juridical double taxation[38] exists on the management fees earned by Mr. Res in terms of the domestic law of South Africa (tax on worldwide income) and that of Botswana (tax at source).

Where double taxation exists, it is common that relief normally be granted by the resident country.[39] In this regard, consideration is given to whether any domestic relief exists for double taxation on income earned by Mr. Res from Botswana.

### 2.1.5. Domestic relief

South African tax law provides for relief from double taxation by way of either a rebate for qualifying foreign taxes on income or a deduction for non-qualifying foreign taxes on income.[40] A rebate from tax payable in terms of section 6*quat*(1A) is allowed where the income so taxed is considered foreign sourced income. On the other hand, only a deduction is allowed from taxable income in terms of section 6*quat*(1C) where the income so taxed is considered local sourced income. A resident does not have a choice between relief in terms of a rebate or deduction, however it is noted that a rebate on tax payable to the South African Revenue Services ("SARS") is more beneficial than that of a deduction in taxable income.

Subject to certain limitations, in terms of section 6*quat*(1) of the ITA-SA, "any income received by or accrued to a resident, excluding foreign dividends, which is from an actual source outside of South Africa and not deemed to be a source from within South Africa, will qualify for a foreign tax credit".[41]

In order to understand whether Mr. Res qualifies for a tax credit or deduction, it is important to understand what the source of the management fees earned by him is.

***Source of management fees***

There is no universal definition or understanding of the meaning of "source" nor does the ITA-SA define the term. There is however included in section 9(2) of the ITA- SA a list of various income streams which are deemed to be that of a South African source.

Based on this list, management fees may potentially only be covered by sections 9(2)(e) and (f). Per section 9(2):

*"An amount is received by or accrues to a person from a source within the Republic if that amount-*

> *(e) is attributable to an amount incurred by a person that is a resident and is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilization of such*

[38] The imposition of similar income taxes by two or more sovereign countries on the same item of income of the same person for the same tax period.
[39] South African Revenue Services Interpretation Note: No.18 (Issue 3), Rebate of deduction for foreign taxes on income, 2015, (accessed 26 January 2019). Available online: http://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-18%20-%20Rebate%20Deduction%20Foreign%20Taxes%20Income.pdf, page 3.
[40] SARS IN.18, page 3.
[41] SARS IN.18, page 6.

*knowledge or information, unless the amount so received or accrued is attributable to a permanent establishment which is situated outside the Republic;*

*(f) is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information for use in the Republic, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information;…"*[42]

Simplistically, the source of income for the management fees received by Mr. Res cannot be determined with reference to section 9(2)(e) as this section requires that Co B, the entity that incurs the service fee payments, to be a SA resident. Furthermore, the source of the management fee income can also not be determined with reference to section 9(2)(f) on the basis that the services are not used in SA but rather Botswana.

Since the SA-ITA does not provide clear guidance to the source of management fees, case law is considered. The general principles regarding the meaning of 'source' has been laid down by the Supreme Court of Appeal in *CIR v Lever Bros & Ltd.*[43] In this case, it was held that the source of a taxpayer's income should be determined by answering the following two questions:

1. Firstly, what the originating cause of the income received by the taxpayer is (i.e. what work has been done to receive the income); and
2. Secondly, where the location of the above originating cause is.

Alternatively, as determined in *Commissioner of Taxes (SR) v Shein,*[44] it is an established principle in South Africa that the source of income from services rendered is not dependent on where the service contract is signed or where payment is made, but rather where the service is rendered.

In this regard, where services are provided by Mr. Res to BCo whilst physically present in Botswana, the management fees earned by him will be considered foreign sourced income. As such, in terms of South African domestic relief, a rebate in terms of section 6*quat*(1A) may potentially apply on foreign taxes incurred and paid to the BRS.

In application of section 6*quat*(1A) "*the rebate shall be an amount equal to the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic, without any right of recovery by any person (other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment prior to such year of assessment)".*[45]

According to the South African Revenue Services ("SARS"), "a tax will be 'proved to be payable' if the SA resident has an unconditional legal liability to pay the tax and the SA resident has either paid the tax or will have to pay the tax in the future".[46] SARS's view is further that an unconditional legal liability in the context of section 6*quat* means that the foreign tax must have been levied legitimately in terms of the foreign jurisdiction's tax law.[47] SARS further notes that "withholding taxes are

[42] ITA- SA, sec. 9(2).
[43] *CIR v Lever Bros & Ltd,* AD 441, 14 SATC 1, 1946.
[44] *Commissioner of Taxes (SR) v Shein,* 22 SATC 12, 1958 (3) SA 14(FC).
[45] ITA- SA, section 6*quat*(1A).
[46] SARS IN18, page 16.
[47] SARS IN18, page 16.

generally triggered at the point in time at which the payor makes the payment to the payee and that this is the point in time which the foreign tax is 'proved to be payable'".[48]

SARS interprets the term 'right of recovery by any person' very broadly and notes that it includes any form of relief against a foreign tax liability - such as a refund, credit, rebate, remission, deduction or any other form of economic benefit (e.g. services or fees). The withholding tax levied in Botswana is a final tax and as such no relief is obtained from the BRS for taxes effectively paid by Mr. Res.

In this regard, Mr. Res will qualify for credit relief in terms of section 6*quat*(1A) where he can prove that he had, through the tax withheld and paid by BCo, paid tax to the BRS. In this regard, it is practice that a withholding tax certificate may be requested from the BRS as proof of foreign taxes paid. The amount of the tax credit available to Mr R is however limited in terms of section 6*quat*(1B) to the following formula:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Taxable income derived from all sources}} \times \text{SA normal tax payable}$$

The purpose of this limitation is to ensure that the foreign rebate granted, only relates to the foreign income included in the SA resident's taxable income. Where the foreign taxes exceed the rebate determined, the excess may not be refunded but is carried forward to the immediately succeeding year of assessment, when it will be deemed to be an amount of foreign tax paid in that year. It may then be set off against the normal tax payable by the resident during that year on foreign income that is included in taxable income. The excess may not be carried forward for more than seven years of assessment, reckoned from the year of assessment when the excess amount was carried forward for the first time.

Assuming no limitation applies, a tax credit on normal tax payable by Mr. Res of R45,000 on foreign tax withheld in Botswana is receivable by Mr. Res from SARS. In effect no double juridical tax exists where the full credit for tax paid in the source state is re-imbursed in the resident state (South Africa). Effectively, Mr. Res will be subject to an effective tax rate of 30%, which is the South African tax rate. Mr. Res' taxable income is illustrated as follows:

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| Section 6*quat*(1A) credit | | | -R 45,000 |
| **Botswana** | | | |
| Management fee WhT | (@15%) | | R 45,000 |
| **Total tax payable** | | | **R 90,000** |
| **Effective tax** | | | **30%** |

[48] SARS IN18, page 16.

Alternatively, as noted above, should Mr. Res perform his service to Co B whilst present in South Africa, the source of income would be considered local in which case only a deduction in terms of s6*quat* (1C) may potentially apply to taxable income of Mr. Res. This is assessed further.

In terms of section 6*quat*(1C), a taxpayer is provided relief against taxable income in the form of a deduction for the sum of any taxes '*paid or proved to be payable*' to any other sphere of Government on South African sourced income. The deduction in such year will be subject to the limitation contained in section 6*quat*(1D). In this regard, the deduction per section 6*quat*(1C) is limited to taxable income that is attributable to income which is subject to tax as contemplated in section 6*quat*(1C) in such year. Any amount limited in terms of section 6*quat*(1D) is a permanent difference and may not be carried forward to the next year.

Assuming no limitations apply, Mr. Res will receive a deduction from his taxable income of R300,000 for the R45,000 withholding tax paid to the BRS. Normal tax payable to SARS (at a rate of 30%) is thus calculated on a reduced taxable income amount of R255,000. In effect, Mr. Res unfortunately does not receive full domestic relief for tax paid in Botswana. As illustrated in the below table, Mr. Res is effectively subject to 41% tax, an increase of 11% on his normal income tax rate of 30%.

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| Section 6*quat*(1C) deduction | (@30%) | -R 45,000 | -R 13,500 |
| **Botswana** | | | |
| Management fee WhT | (@15%) | | R 45,000 |
| **Total tax payable** | | | **R 121,500** |
| **Effective tax** | | | **41%** |

Based on this illustration, it is evident that where the source of income is within South Africa, a portion of Mr. Res' income earned will be subject to double juridical tax.

The tax effect as illustrated above in both cases may potentially change in application of the South Africa- Botswana treaty. The treaty provisions, which may provide for different profit-sharing taxing allocations and/or deeming source rules, will have preference to that of domestic law. In this regard, the tax effect may potentially change due to the treaty. The tax effect on Mr. Res in application of the South Africa- Botswana treaty is thus considered further.

### 2.1.6. South African- Botswana treaty provisions

The Convention between The Government of The Republic of South Africa and the Government of The Republic of Botswana for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income ("the South Africa- Botswana treaty") was concluded on 7 August 2003. The entry into force date was 20 April 2003 with effective date being 1 January 2004. In

addition, a protocol was signed on 21 May 2013 entered into force on 19 August 2015 and is effective as of 1 January 2016 and is incorporated into the main text of the treaty.

As previously highlighted, the South Africa- Botswana treaty includes a specific article on technical services as envisioned in the 2017 UN Model. Article 20- *Technical fees* of the South Africa-Botswana treaty reads as follows:

1. *"Technical fees arising in a Contracting State which are derived by a resident of the other Contracting State may be taxed in that other State.*

2. *However, such technical fees may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but where such technical fees are derived by a resident of the other Contracting State who is subject to tax in that State in respect thereof, the tax charged in the Contracting State in which the technical fees arise shall not exceed 10 per cent of the gross amount of such fees.*

   *The competent authorities of the Contracting States shall settle the mode of application of this limitation by mutual agreement.*

3. *The term "technical fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of an administrative, technical, managerial or consultancy nature.*

4. *The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the technical fees, being a resident of a Contracting State, carries on business in the other Contracting State in which the technical fees arise, through a permanent establishment situated therein and the technical fees are effectively connected with such permanent establishment. In such a case, the provisions of Article 7 shall apply.*

5. *Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the technical fees, whether that person is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the obligation to pay the technical fees was incurred, and such technical fees are borne by that permanent establishment, then such technical fees shall be deemed to arise in the State in which the permanent establishment is situated.*

6. *Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the technical fees paid exceeds, for whatever reason, the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention."* [49]

[49] Art. 20: South Africa- Botswana treaty.

***Application***

Article 20 is applied to management fees earned by Mr. Res as follows:

i. Technical fees as per paragraph 3 includes payments received for services of an administrative, technical, managerial or consultancy nature. As such, the management fee earned by Mr. Res falls within the ambit of Article 20.
ii. Taxing rights in paragraph 1 is primarily allocated to South Africa the resident country of Mr. Res. In line with domestic rules of taxing a resident's worldwide income, South Africa may tax the management fees earned by Mr. Res.
iii. In addition to resident state tax rights, paragraph 2 also allows the Source State (the state in which the fees arise) to tax technical services at a gross amount in terms of domestic rules. The tax is limited to 10%.
iv. The State in which fees arise is specifically defined in paragraph 5 to be the State in which the payer of the fees is a resident. In this regard, the Source State is Botswana where BCo had incurred an amount of R300,000 for management service provided by Mr. Res. Botswana is thus allowed to levy a withholding tax in terms of its domestic law on the gross amount, limited to 10%.
v. In further analysing the treaty provisions, contrary to the South African domestic law, where the source of income is considered the state in which the service is provided, the "deeming source" rule per Article 20 paragraph 3 limits the source of income only to be from the state in which the payor of the fee is resident. In this regard, the source of the service fee can only be Botswana, the State where BCo the payor is resident, irrespective if Mr. Res performs his service from South Africa.
vi. BCo should in terms of application of domestic and treaty law, withhold 10% tax to be paid to the BRS on the management fees earned by Mr. Res.

It is evident that double juridical tax exists on the management fee earned by Mr. Res on the basis that South Africa taxes his worldwide income and Botswana is allowed to levy a withholding tax on the same fees. In this regard treaty relief is considered further.

### 2.1.7. South African- Botswana treaty relief

"In terms of model treaty conventions, relief can be provided in terms of either the exemption method or the credit method as per Article 23A and 23B. These articles deal with the so-called juridical double taxation where the same income or capital is taxable in the hands of the same person by more than one state".[50] Furthermore it is noted that "Article 23A and 23B apply to the situation in which a resident derives income from, or owns capital in, the Other Contracting State and such income, in accordance with the Convention, may be taxed in such other State. The articles, therefore apply only to the State of residence and do not prescribe how the other Contracting State has to proceed".[51]

[50] Vogel, K. 2015. *Klaus Vogel on Double Taxation Conventions*, 4th Edition, Kluwer Law International, The Netherlands, Article 23, para. 1, page 1586.
[51] Vogel: Art. 23, para. 8, page 1587.

*The principle of exemption*

"Under the principle of exemption, the State of residence does not tax the income which according to the Convention may be taxed in the Source State. The principle of exemption may be applied in two main methods:

a) The income which may be taxed in State S is not taken into account at all by State R for purposes of its tax: State R is not entitled to take the income so exempted into consideration when determining the tax to be imposed on the rest of the income; this method is the 'full exemption' method.
b) The income which may be taxed in State S is not taxed by State R, but State R retains the right to take that income into consideration when determining the tax to be imposed on the rest of the income; this is called 'exemption with progression'."[52]

*The principle of credit*

"Under the principle of credit, the State of residence calculates their tax on the basis of the taxpayer's total income including the income from the other State S which, according to the Convention, may be taxed in that other State. It then allows a deduction from their own tax paid in the other State. The principle of credit may be applied by two main methods:

a) State R allows the deduction of the total amount of the tax paid in the other State on income which may be taxed in that State, this method is called 'full credit'.
b) The deduction given by State R for the tax paid in the other State is restricted to that part of its own which is appropriate to the income which may be taxed in the other State: this is method is called 'ordinary credit'."[53]

Fundamentally, the difference between the methods is that the exemption method looks at income, while the credit method looks at tax. Based on the domestic law analysis done previously, it can be noted that South Africa uses the credit method to provide domestic relief for double taxation. In terms of section 6*quat*, relief is not provided domestically where treaty relief is received.[54]

In terms of Article 22 of the South Africa- Botswana treaty, relief is provided as follows:

1. *"Double taxation shall be eliminated as follows:*

   *(a) In Botswana, subject to the provisions of the laws of Botswana regarding the allowance of a credit against Botswana tax of tax payable under the laws of a country outside Botswana, South African tax payable under the laws of South Africa and in accordance with this Convention, whether directly or by deduction, on profits or income liable to tax in South Africa shall be allowed as a credit against any Botswana tax payable in respect of the same profits or income by reference to which the South African tax is computed. However, the amount of such credit shall not exceed the amount of the Botswana tax payable on that income in accordance with the laws of Botswana.*

[52] Vogel: Art. 23, para. 13-14, page 1588.
[53] Vogel: Art. 23, para. 15-16, page 1589.
[54] Vogel: Art. 23, para. 17, page 1589.

*(b) In South Africa, 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, Botswana tax paid by residents of South Africa in respect of income taxable in Botswana, in accordance with the provisions of this Convention, shall be deducted from the taxes due according to South African fiscal law. Such deduction shall not, however, exceed an amount which bears to the total South African tax payable the same ratio as the income concerned bears to the total income."*[55]

In application of paragraph 1b), on the basis that Mr. Res' income is subject to tax in Botswana, the amount taxable in Botswana should, subject to South African domestic law, be allowed as a credit against South African income tax payable.

In line with section 6*quat* of South African domestic law, in terms of treaty relief, a credit should be applied in South Africa to the tax incurred in Botswana.

In effect, there is no double juridical tax on income earned by Mr. Res in application of the South Africa- Botswana treaty, irrespective of where the service is provided. The neutrality on Mr. Res' tax payable as a resident of South Africa is illustrated as follows:

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| Treaty relief | | | -R 30,000 |
| **Botswana** | | | |
| Management fee WhT | (@10%) | | R 30,000 |
| **Total tax payable** | | | **R 90,000** |
| **Effective tax** | | | **30%** |

It is worthwhile to note that exchange rates could however have an impact on the true neutrality of taxation incurred by Mr. Res. In this regard, withholding tax on management fees earned in Botswana will be withheld in local currency of Pula, however in terms of section 6*quat*(4) the "*amount of any foreign tax proved to be payable as contemplated in subsection (1A) or any amount paid or proved to be payable as contemplated in subsection (1C) in respect of any amount which is included in the taxable income of any resident during any year of assessment, shall be translated to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment*".[56] As such, on the basis that the South African credit or deduction is based on the average exchange rate on the last day of the year of assessment compared to the exchange rate as at the date of withholding, there is a potential difference in the Rand value as received as a deduction or credit to the translated Rand amount as withheld in Botswana.

[55] Art. 22: South Africa- Botswana treaty
[56] ITA- SA, sec. 6*quat*(4).

In this regard, it is illustrated that even if South Africa exempted Mr. Res from tax in South Africa, there is potential unrecovered taxation on the 10% withholding tax paid in Botswana due to exchange differences. This is not explored in further detail in this paper however could potentially be an area for further consideration.

### 2.1.8. Complete illustration of tax on management fees earned from Botswana

Mr. Res, a resident of South Africa, had performed consulting services for BCo, a company incorporated in Botswana. In an attempt to protect their tax base, in terms of Botswana domestic law, a final tax is payable to the Botswana Revenue Services (the "BRS") for payments made to non-residents, at a withholding tax rate of 15% on the gross amount. In this regard, Mr. Res' income earned of R300,000 was subject to withholding tax of R45,000 and a net amount of R255,000 is thus paid by BCo to Mr. Res.

In South Africa however, Mr. Res is subject to tax on his worldwide income which is taxable on the full R300,000. In effect, through the application of each State's domestic law, double juridical tax exists. South African domestic relief may apply in terms of section 6*quat* dependent on the source of income. Where the source of income is from Botswana, a full credit is provided in terms of section 6*quat*(1A) and double taxation is eliminated. However, where the source of income is from South Africa, only a deduction to taxable income is provided in terms of section 6*quat*(1C). In effect, where only a portion of the tax paid to Botswana is relieved through South African domestic law, double taxation remains.

The South Africa- Botswana treaty includes Article 20- *Technical services,* which applies to management fees earned by Mr. Res. In this regard, the treaty provisions override that of domestic law. Article 20 allows both the Resident and Source State to tax the management fees. A withholding tax at Source State is however limited to 10%. In terms of the treaty, the source of income is deemed to be the state in which the payor is resident. In this regard, where double tax exists due to treaty provisions, the provisions of Article 22- *Elimination of Double Taxation* is applied, in which a credit for tax incurred in Botswana is provided by South Africa (the resident state).

As such, a full credit on the 10% withholding tax on R30,000 paid to the BRS in terms of the South Africa- Botswana treaty is provided as a credit to Mr. Res. In this regard, the application of the South Africa-Botswana treaty (which overrides the domestic rules) eliminates double juridical tax on management fees earned by a South African resident as earned from Botswana, irrespective of where the service is performed.

It is however noted that although treaty relief provides tax neutrality, this in fact does not hold true on exchange rate differences realised on the translation of foreign withholding taxes for purposes of section 6*quat* relief. This is not explored in detail in this paper however may be an area that can be explored further.

As illustrated, the tax on management fees and corresponding relief is clear in the South Africa-Botswana treaty given the inclusion of an article similar to Article 12A. Any further analysis of other treaty provisions (i.e. application of independent personal services) is not required.

## 2.2. Treatment of management fees in terms of the South Africa- Zambia treaty

### 2.2.1. Abstract

The tax effect on management fees received by Mr. Res, a South African resident, for services performed to a Zambian incorporated entity is analysed. The case study considers the tax effect of the management fees earned by taking into account South African and Zambian domestic law. Consideration is also then given to the potential South African domestic relief available to Mr. Res.

This section aims to analyse whether there is a change to the domestic tax effect in application of the South Africa- Zambia treaty which does not have an article similar to the new Article 12A- *Fees on technical services* as included in the 2017 United Nation Double Taxation Convention between Developed and Developing Countries ("the UN Model") to which management fees may apply.

It is found, as illustrated in Appendix A, that in practice majority of developing countries had in an attempt to protect their tax base incorporated in their domestic law, a tax on a gross basis on technical services paid to non-residents. A withholding tax is thus paid in the source country. This in effect leads to double juridical taxation which may potentially not be eliminated through domestic or treaty relief.

The domestic and treaty provisions are thus analysed in order to ascertain whether double juridical taxation remains and what the impact of this for Mr. Res and for South Africa as a whole is.

The analysis is performed through the application of an illustrative example.

### 2.2.2. Illustrative example

The same illustrative example as in section 2.1.2 is considered with reference to management fees received by Mr. Res for services now rendered to ZCo, a company incorporated in Zambia. The domestic tax rules for South Africa as highlighted in section 2.1.3 remain the same in this scenario. The domestic tax rules of Zambia are considered further to understand if double juridical taxation occurs in this regard.

### 2.2.3. Domestic tax principles of Zambia (Source State)

i. In terms of section 4 of the Income Tax Act- Chapter 323 of the Laws of Zambia ("ITA-Zambia") "an individual is not considered a resident of Zambia if he is present for only a temporary purpose and if he has not stayed in Zambia at any one time for a period equal to in total 183 days in any tax year".[57]
ii. "In terms of section 14 of the ITA- Zambia, tax is charged on the income received in a tax year by every 'person'[58] from a source within or deemed to be within Zambia and on the income of every resident person who is in receipt of interest or dividends from a source outside Zambia".[59]

[57] Country Tables Comparison, IBFD.
[58] Defined as "a person other than an individual is resident in the Republic for any charge year if the control and management of the person's business or affairs are exercised in the Republic for that year".
[59] Munyandi. K. 2018. *Zambia – Corporate Taxation*, Country Analyses, IBFD, introduction (accessed 23 September 18). Available online: https://online-ibfd-org.ezproxy.uct.ac.za/document/gtha_zm_chaphead.

iii. The administration and collection of taxes in Zambia is vested in the Commissioner General of the Zambia Revenue Authority (the "ZRA").

iv. In terms of tax payable on management fees specifically, "income is deemed to have a source in Zambia if it arises from a management or consultancy fee incurred in the production of income or in the carrying on of a business in Zambia and is received by a person or persons in partnership for a service other than such part thereof as is rendered by the person or persons in partnership in the carrying on of a business in Zambia".[60] "Commissions, and management and consultancy fees paid to non-resident companies and non-resident individuals are subject to final withholding tax of 20% on a gross basis".[61]

v. Co Z is thus liable to withhold a 20% withholding tax on the payment of R300,000 paid to Mr. Res on the basis that payment is made to a non-resident individual for management fees. In this regard, Mr. Res will receive a net payment of only R240,000 and R60,000 will be paid over to the ZRA.

As Mr. Res is a resident of South Africa, in terms of South African domestic law he will be taxed on the management fees earned from ZCo as being part of his worldwide 'gross income'. It is assumed that Mr. Res will be subject to an effective South African domestic tax rate of 30%. In this regard, he will be liable for normal South African income tax payable of R90,000 (R300,000 x 30%).

Where Mr. Res provides his services in Zambia, he cannot be considered a resident of Zambia as he only provided his services to ZCo for a period of 60 days. In terms of Zambian domestic law, a 20% withholding tax is payable by ZCo on the payment made to Mr. Res, on the basis that payment is made to a non-resident individual for technical fees. On the R300,000 income earned by Mr. Res he will only receive a net cash payment of R240,000 and R60,000 (R300,000 x 20%) as withheld by ZCo will be required to paid over to the ZRA.

It is evident that international juridical double taxation[62] exists on the management fees earned by Mr. Res in terms of the domestic law of South Africa (tax on worldwide income) and that of Zambia (tax at source). As highlighted in section 2.1.5. in terms of domestic relief, Mr. Res will potentially not be subject to double tax where income earned is foreign sourced income i.e. where his services are performed whilst in Zambia. However double juridical taxation will exist where the source of income is local where his services are provided whilst in South Africa. In this regard, consideration is given to whether any treaty relief exists for double taxation on income earned by Mr. Res from Zambia.

### 2.2.4. South African- Zambia treaty relief

The agreement between The Government of the Union of South Africa and The Government of the Federation of Rhodesia and Nyasaland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income is one of the older treaties. The treaty was concluded on 22 May 1956 with entry into force as of 31 August 1956 and effective dates were 1 April 1953 in Zambia and 1 July 1953 in South Africa. This agreement was originally entered into by the Federation of Rhodesia and Nyasaland but now applies to Zambia.

[60] Munyandi. 2018, sec. 6.1.1.1.
[61] Munyandi. 2018, sec. 6.3.4.
[62] The imposition of similar income taxes by two or more sovereign countries on the same item of income of the same person for the same tax period.

In terms of treaty application, as noted in the introduction to this paper, the South African- Zambia treaty does not include a specific article or provisions in relation to technical services. Based on previous illustrations and in terms of domestic laws Mr. Res may potentially be subject to double juridical taxation, especially where the management fees received are that of South African source, in which only a deduction from taxable income for foreign tax is received by a resident of South Africa.

It is further assessed whether the South Africa- Zambia treaty may apply where double taxation occurs on management fees earned by a South African resident for services rendered to Zambia which is taxed by both States. In this regard, it is noted the South African- Zambia treaty has a specific Article IX which provides for the exemption of tax on an individual in respect of personal (including professional) services performed in either of the States. Article IX reads as follows:

1. *"An individual who is a resident of the Union (South Africa) shall be exempt from Federal (Zambian) tax on profits or remuneration in respect of personal (including professional) services performed within the Federation (Zambia) in any year of assessment if –*

    a) *he is present within the Federation (Zambia) for a period or periods not exceeding in the aggregate 183 days during that year; and*
    b) *the services are performed for or on behalf of a person resident in the Union (South Africa); and*
    c) *the profits or remuneration are subject to Union tax (South Africa)*

2. *An individual who is a resident of the Federation (Zambia) shall be exempt from Union (South Africa) tax on profits or remuneration in respect of personal (including professional) services performed within the Union (South Africa) in any year of assessment if –*

    a) *he is present within the Union (South Africa) for a period or periods not exceeding in the aggregate 183 days during that year; and*
    b) *the services are performed for or on behalf of a person resident in the Federation (Zambia); and*
    c) *the profits or remuneration are subject to Federal (Zambian)l tax.*

3. *The provisions of this Article shall not apply to the profits or remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes."*[63]

In terms of paragraph 1, Mr. Res may potentially be exempt from Zambian tax on personal services provided in Zambia. Based on the subsection (b), the exemption from tax in Zambia will however not apply given that the management consulting service was provided by Mr. Res to a Zambian resident and thus is not '*for or on behalf of a person resident in South Africa*'. Paragraph 2 will not apply to Mr. Res as he is a resident of South Africa and not Zambia.

The general treaty provisions which relate to the elimination of double taxation are thus considered per Article XII of the South Africa- Zambia treaty. The provisions of Article XII reads as follows:

1. *"Subject to the provisions of the law in the Federation (Zambia) regarding the allowance of a credit against Federal (Zambian) tax of tax payable in the Union (South*

[63] Art. IX: South Africa- Zambia treaty

*Africa), Union (South African) tax payable in respect of profits from sources within the Union (South Africa) shall be allowed as a credit against any Federal (Zambian) tax payable in respect of such profits.*

2. *Where Federal (Zambian) tax is payable in respect of profits derived from sources within the Federation (Zambia) by a person ordinarily resident in the Union (South Africa), the Union (South Africa) shall either impose no tax on such profits or, subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the Union (South Africa), shall allow the Federal (Zambian) tax as a credit against any Union (South African) tax payable in respect of such profits.*

3. *For the purposes of this Article profits or remuneration for personal (including professional) services performed in one of the territories shall be deemed to be profits from sources within that territory, and the services of an individual whose services are wholly or mainly performed in aircraft or other transport vehicles operated by a resident of one of the territories shall be deemed to be performed in that territory."*[64]

Paragraphs 1 and 2 of Article XII make reference to tax on "profits" which is specifically defined in the treaty to be "taxable income" as defined under the laws of the Contracting Governments relating to the taxes which are the subject of the treaty. In this regard, it is evident that treaty relief does not apply on the basis that the tax paid is a withholding tax rather than a tax on profits. In addition, despite the lack of Article 12A, the analysis shows that there is nothing in the tax treaty that prohibits Zambia from levying the withholding tax. As such, tax payable by Mr. Res as illustrated below is effectively 50% on management fees earned from Zambia.

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| **Zambia** | | | |
| Management fee WhT | (@20%) | | R 60,000 |
| **Total tax payable** | | | **R 150,000** |
| **Effective tax** | | | **50%** |

In terms of Article I(2) however, the treaty shall also apply to "any taxes of a substantially similar character (to normal and supertax) imposed by either contracting Government subsequently to the date of signature of the Agreement."[65] In this regard, the treaty may potentially apply to withholding tax where it is considered to be substantially similar in character to normal or supertax already in effect at date of signature of the treaty. This aspect is not considered in detail and assumed not to apply.

[64] Art. XII: South Africa- Zambia treaty
[65] Art. I: South Africa- Zambia treaty

As such, in order to further assess the potential for treaty relief to apply, it is considered to what extent the management fee is or may be taxable in terms of other treaty provisions. This is considered further.

### 2.2.5. Other provisions to which management fees may apply in terms of the South Africa- Zambia treaty

In gaining a holistic understanding of articles or provisions of the South Africa- Zambia treaty which may apply to the management fees of Mr. Res, the articles of the UN and OECD Models are considered as a first point of reference in application to management fees in general.

In this regard, this paper draws on the articles of the UN and OECD Models which potentially apply distributive rules to management fees. It is then considered to what extent the South Africa- Zambia treaty has the same or similar articles or provisions as those of the Model Conventions and to what extent the provisions in the treaty then apply to the management fees earned by Mr. Res. This is based on the understanding that treaties are generally drawn up using Model Conventions as a point of reference, however certain deviations as the countries negotiate, may apply.

For completeness, the South Africa- Zambia treaty is further considered in its entirety in ascertaining whether any other provisions or articles, which is not found in the UN or OECD Models as discussed, may apply to management fees.

In doing this analysis, Model Commentary is used as a guideline in understanding whether the provisions of the South Africa- Zambia treaty, which is found to be the same or similar to that of the UN or OECD Models, apply distributive rules in relation to management fees earned by Mr. Res.

*Articles of the UN/ OECD Model which apply to management fees*

Through the nature of services and in application of the articles as contained in UN and OECD Models, technical services could fall in the ambit of being independent personal services or considered taxable as part of business profits. In addition, in certain cases, based on the definition applied, technical services could also be considered a royalty.

In this regard, Article 14- *Independent services* of the UN Model and Articles 7- *Business Profits* and 12- *Royalties* in both the UN and OECD Models are considered in this analysis. As noted, the articles of the South Africa- Zambia treaty is then applied with reference to these articles of the Model Conventions and then further applied to the management fee earned by Mr. Res.

**Independent professional services**

*Article 14 of UN Model*

Article 14 of the UN Model provides that:

1. *"Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:*

    a. *If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or*

b. *If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.*

2. *The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants."*[66]

In terms of this article, the key factor in providing Zambia (the Source State) with taxing rights is thus whether Mr. Res has a fixed base which is regularly available to him in Zambia. This fixed base should be available to him for use in performing his consulting services (i.e. professional services) and applies when he is present in the Source State for a period in excess of 183 days in any twelve-month period. In addition, the management consulting service provided by Mr. Res does not fall within the definition of a professional service as defined in paragraph 2.

*Application to the South Africa- Zambia treaty*

The South African- Zambian treaty does not have a specific article on independent personal services. In addition, there are no provisions which are similar to Article 14 of the UN Model. In this regard, management fees earned by Mr. Res will not be taxed in terms of the South Africa- Zambia treaty with reference to his consulting service (i.e. independent personal services) provided to Zambia.

**2.2.5.1. Royalties**

*Article 12 of UN and OECD Models*

Royalties are defined in Article 12 of the UN Model, paragraph 3 (the same wording is contained in Article 12, paragraph 2 of the OECD Model) to mean "payments for the use of, or the right to use, any copyright, patent, trademark, design, plan, secret formula or process, any industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience".[67]

In accordance with UN Model commentary, fees for technical services paid by a resident of one Contracting State to a resident of the other Contracting State cannot generally be taxed as royalties by the State in which the payer is resident. However, some countries take the view that the expression 'information concerning industrial, commercial or scientific experience' includes certain technical services.

It is further elaborated in the UN Model Commentary that "royalties are payments for the use of, or the right to use, intellectual property, equipment or know-how (information concerning industrial, commercial or scientific experience). Thus, royalties involve the transfer of the use of, or the right to use, property or know-how."[68]

[66] Art. 14 UN Model
[67] Art. 12 (3) UN Model.
[68] Para. 4 UN Model: Commentary on Art. 12A, page 319.

"In contrast, when an enterprise provides services to a customer, it does not typically transfer its property or know-how or experience to the customer; instead, the enterprise simply performs work for the customer".[69]

"Countries have different interpretations of the meaning of the expression 'information concerning industrial, commercial or scientific experience' in Article 12, paragraph 3. In this regard, some countries take the position that the provision of brain-work and technical services is covered by this phrase, and therefore payments for such (technical) services are in general taxable under Article 12".[70]

*Application to the South Africa- Zambia treaty*

In terms of Article VI of the South Africa- Zambia treaty *"any royalty, rent (including rent or royalties of cinematograph films) or other consideration received by or accrued to a resident of one of the territories by virtue of the use in the other territory of, or the grant of permission to use in that other territory any patent, design, trade mark, copyright, secret process, formula or other property of a similar nature shall be exempt from tax in that first-mentioned territory if such royalty, rent or other consideration is subject to tax in the other territory".*[71]

A royalty per the treaty is similar to that of the UN Model as it provides for the use of any patent, design, trade mark, copy right, secret process, formula or other property of a similar nature. The provision however excludes wording as included in the UN Model in relation to the use of 'any industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience' which some countries consider including technical services. Based on this limited interpretation, it assumed that management fees are not considered a royalty in regard to the South Africa- Zambia treaty. This is not confirmed and could be considered for further study.

In adding to the analysis however, on the basis that double taxation on Mr. Res is due to the withholding tax on management fees as applied in Zambia, it could be considered to what extent Zambia considers management fees to be a royalty. Simplistically, in terms of its domestic law Zambia applies specific source rules per section 18 (of the ITA- Zambia) to management or consulting fees and that of royalties. As such, although there is a possibility that other technical services may potentially be considered a royalty in Zambia (this has not been assessed in detail), based on the clear distinction between management fees and royalties in domestic law it is assumed that Zambia does not consider management fees to be that of a royalty.

In this regard, it is assumed that management fees of Mr. Res do not fall in the ambit of royalties in terms of the treaty. Article 7 which applies to the tax on business profits is considered further.

**2.2.5.2. Business profits**

*Article 7 of UN and OECD Models*

Article 7- Business Profits of both the UN and OECD Models incorporates the principle that unless an enterprise of a Contracting State has a PE situated in the Other State, the business profits of that enterprise may not be taxed by the Other State. In this regard, Article 5 which includes the definition of the concept of a PE is also relevant to the analysis.

[69] Para. 4 UN Model: Commentary on Art. 12A, page 319.
[70] Para. 5 UN Model: Commentary on Art. 12A, page 320.
[71] Art. VI: South Africa- Zambia treaty.

In terms of Article 7(1) of the UN model "*the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment; (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment*".[72]

Article 7(1) of the OECD Model provides for similar provision as *"profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State"*.

"The term 'enterprise' is neither defined in OECD nor UN Model. In terms of OECD commentary however the question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States".[73] It further notes that there is no exhaustive definition of the term 'enterprise' however, it is provided that "the term applies to the carrying on of any business; since the term 'business' is expressly defined to include the performance of professional services and of other activities of an independent character in".[74] "This clarifies that the performance of professional services or other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law".[75]

*Application to the South Africa- Zambia treaty*

The article on business profits is considered in terms of the South African- Zambia treaty. Article III of the treaty reads as follows:

1. *"The <u>industrial and commercial profits</u> of an enterprise in one of the territories shall not be subject to tax in the other territory unless the enterprise is engaged in trade or business in the other territory through a permanent establishment in that other territory. If it is so engaged <u>tax may be imposed on those profits by the other territory</u> but only on so much of them as is attributable to that permanent establishment.*

2. *Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein –*

   *(a) there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment;*

[72] Art. 5(1) UN Model.
[73] Para. 4 OECD Model: Commentary on Art. 3.
[74] Para. 4 OECD Model: Commentary on Art. 3.
[75] Para. 4 OECD Model: Commentary on Article 3.

*(b) subject to the provisions of sub-paragraph (a) no profits derived from sources outside that other territory shall be attributed to that permanent establishment."*[76]

It is highlighted that contrary to the OECD and UN Model, in terms of paragraph 1, only the 'industrial and commercial profits' of an enterprise is taxable in the state of Source if the enterprise has a PE in such State.

In terms of Article II of the treaty, 'industrial and commercial profits' is specifically defined in the definition of an *industrial or commercial enterprise or undertaking* and "includes an enterprise or undertaking engaged in mining, agricultural or pastoral activities or in the business of banking, insurance or dealing in investments, and *"industrial or commercial profits"* includes profits from such activities or business but does not include income in the form of dividends, interest, rents, royalties (including rent or royalties of cinematograph films), management charges, remuneration for personal services or profits from the operation of transport services".[77]

In light of the definition of 'industrial and commercial profits' where management fees are specifically excluded, the management fees as earned by Mr. Res does not fall in the ambit of Article III and is not taxable in terms of this treaty article.

#### 2.2.5.3. Other provisions

As a default, Article 21- *Other income* per the UN and OECD Models may apply, however the South African –Zambia treaty does not make reference to provisions similar to this article. Additionally, there are no further articles or provisions in the South Africa- Zambia treaty to which management fees may apply.

In this regard, based on a simplistic analysis, it is evident that the management fees of Mr. Res are not covered by the terms of the South Africa- Zambia treaty. As such, irrespective of the fact that Zambia taxes the management fees at a domestic level, treaty relief in terms of the South Africa- Zambia treaty does not apply, on the basis that no distributive rules apply to the Source State (Zambia) in terms of the treaty. As such, double taxation remains on management fees earned by Mr. Res.

### 2.2.6. Complete illustration of tax on management fees received from Zambia

Mr. Res, a resident of South Africa, had performed consulting services for ZCo, a company incorporated in Zambia. In an attempt to protect their tax base, in terms of Zambian domestic law, a final tax is payable to the Zambia Revenue Authority (the "ZRA") for payments made to non-residents, at a withholding tax rate of 20% on the gross amount. In this regard, Mr. Res' income earned of R300,000 was subject to withholding tax of R60,000 and a net amount of R240,000 is thus paid by ZCo to Mr. Res.

In South Africa Mr. Res is subject to tax on his worldwide income which is taxable on the full R300,000 earned. In effect, through the application of each State's domestic law, double juridical tax exists. In terms of domestic law, South Africa provides relief in terms of section 6*quat.* The amount of relief provided depends on the source of income and whether no other benefit is obtained.

[76] Art. III: South Africa- Zambia treaty
[77] Art. II: South Africa- Zambia treaty

Where the source of income is foreign (i.e. services are provided in Zambia), a full credit is provided in terms of section 6*quat*(1A) and double taxation is eliminated. However, where the source of income is local (i.e. services are provided from South Africa), only a deduction to taxable income is provided in terms of section 6*quat*(1C). In effect, only a portion of tax paid to Zambia is provided as relief in South Africa and double taxation remains.

In this regard, it is considered to what extent treaty relief may apply per the South Africa- Zambia treaty (which overrides the domestic rules) to eliminate the double juridical taxation. It is noted that the South Africa- Zambia treaty does not specifically include an article on technical services as envisaged in the newly drafted 2017 UN Model. In addition, based on a simplistic analysis, the South Africa- Zambia treaty does not include any other articles or provisions to which management fees may apply. In this regard, treaty relief does not apply, and double taxation remains.

The domestic relief available to Mr. Res and the overall effective tax on management fee income earned by him from Zambia is illustrated as follows:

*Source from Zambia*

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| Section 6*quat*(1A) credit | | | -R 60,000 |
| **Zambia** | | | |
| Management fee WhT | (@20%) | | R 60,000 |
| **Total tax payable** | | | **R 90,000** |
| **Effective tax** | | | **30%** |

*Source from South Africa*

| | | Taxable income | Normal tax payable |
|---|---|---|---|
| **South Africa** | | | |
| Management fee income | (@30%) | R 300,000 | R 90,000 |
| Section 6*quat*(1C) deduction | (@30%) | -R 60,000 | -R 18,000 |
| **Zambia** | | | |
| Management fee WhT | (@20%) | | R 60,000 |
| **Total tax payable** | | | **R 132,000** |
| **Effective tax** | | | **44%** |

It is thus illustrated that, where the source of income is from Zambia (services provided in Zambia), a credit is provided by South Africa and double taxation is illuminated. However, where the source of

income is from South Africa (services provided in South Africa), Mr. Res effectively pays tax of 44%. Double juridical tax thus exists on management fee income as earned by Mr. Res from Zambia where the services are performed from South Africa, even though a double tax agreement is in place between South Africa and Zambia.

Based on this illustration, it is evident that there is a difference in the tax effect on Mr. Res for the same amount of income as earned in Botswana and Zambia where the South Africa- Botswana treaty has an article similar to that of Article 12A- Fees on technical services compared to the South Africa-Zambia treaty which does not have any reference to a similar article.

## CHAPTER 3: CONCLUSION

An individual or enterprise providing personal services can substantially be involved in another state's economy without establishing a permanent establishment ("PE") or fixed base. In this regard, an importing country (i.e. the Source State) may not have any taxing rights on the services being provided in the country as there is no fixed base, however it would in most cases be required to provide it's resident a deduction for expenses incurred in receiving that service, on the basis that the expenses incurred by the resident are legitimate costs incurred in the production of income of the entity. In an attempt to protect their tax base due to the above, it is found that developing countries would incorporate in their domestic law a withholding tax on services.

As such, the taxation of income from technical, managerial, consultancy and other similar services ("technical services") has been a key concern for many countries in that it "had resulted in difficult disputes, both for taxpayers and administrations, consuming scarce resources, as well as causing unrelieved double taxation or double non-taxation".[78] This goes against the aim of bilateral tax treaties to prevent certain types of discrimination as between foreign investors and local taxpayers, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations can confidently be carried on.

In light of this, Article 12A- *Fees on technical services* had been drafted into the 2017 United Nation Double Taxation Convention between Developed and Developing Countries ("the UN Model") which allows a Source State to impose a withholding tax on payments by a resident/ PE to the other state of qualifying fees in the absence of the recipient having a PE in the paying country.[79]

Through illustration, it was considered whether there was a difference in the tax effect on Mr. Res, a South African resident, in the provision of managerial services to Botswana and Zambia, where the South Africa- Botswana treaty has a similar article to Article 12A compared to the South Africa- Zambia treaty which does not have a similar article.

In answering the research question as to whether the inclusion of the technical service article in a treaty has a different effect on the taxing rights over management fees and whether Article 12A is in line with the general objective to protect a taxpayer against double taxation, the following was illustrated through application of a case study:

i. In application of the domestic law of South Africa, Botswana and Zambia, double taxation occurs on services provided by a South African individual to a Botswana and Zambian incorporated entity.
ii. In terms of South African domestic relief, 100% relief may apply where services are foreign sourced income (i.e. where the service is provided from Botswana or Zambia). However double juridical taxation remains where services are local sourced income (i.e. where the service is provided from South Africa).
iii. The application of the South Africa- Botswana treaty which includes an article similar to Article 12A per the 2017 UN Model provides 100% relief for double juridical taxation irrespective of the source of income.

[78] Para. 6 UN Model: Commentary on Art. 12A, page 320.
[79] Para. 1 UN Model: Commentary on Art. 12A, page 318.

iv. Double juridical taxation remains in application of the South Africa- Zambia treaty which does not include provisions similar to Article 12A.

As part of the case study, as illustrated in sections 2.1.8 and 2.2.6, double juridical taxation remains in application to management fees in terms of the South Africa- Zambia treaty which does not include a technical service article. In this regard, the inclusion of a specific article on technical services makes the application of treaty relief easier. Where no article on technical services (in application to management fees) is included in a treaty, it may become burdensome to prove that treaty relief, which provides the most benefit, may apply.

Based on data in Appendix A and B, it can be deduced that there is a large amount of exports to other African Countries, which majority provide for a withholding tax on services paid to non-residents. In this regard, where individuals or companies are based in and provide their services from South Africa i.e. services are local sourced income, there is a possibility that double juridical taxation occurs where the countries in question do not have a treaty with South Africa or such treaty does not make reference to an article similar to Article 12A.

South Africa itself does not levy a withholding tax thus double taxation will not be an issue where services are imported. In this regard, foreign investment into South Africa is not hindered. However, for multinational corporations or individuals who are resident in South Africa and export personal services, performed from South Africa, double juridical taxation becomes an issue and leads to increased costs. These increased costs could hinder the growth of the company and economy of South Africa as a whole. In this regard, on the basis that in practice developing countries would domestically levy a withholding tax, it would be beneficial to have the technical service article included in treaties with these countries.

In relation to Zambia, the treaty dates back to the 1950's and as such would be outdated in relation to various changes in model treaties and international treaties. It is understood that the treaty is under review and changes are expected. The date and changes to the treaty however is not confirmed. On the basis that large amounts of exports are made from South Africa to Zambia, it is recommended that an article similar to Article 12A is included in the treaty by protocol or renegotiation of the treaty.

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## APPENDIX A: SUMMARY OF TYPES OF TECHNICAL SERVICES TAXED ON SOURCE BASIS IN AFRICAN DEVELOPOING COUNTRIES

| Country | Non-resident companies | | Non-resident individuals |
|---|---|---|---|
| | Fees (technical) | Fees (management) | Fees (technical) |
| **Algeria** | 24% | 20% | 24% |
| **Angola** | 6.5% | 6.5% | **No** |
| **Benin** | 12% | 12% | 10% |
| **Botswana** | 15% | 15% | 15% |
| **Burkina Faso** | 20% | 20% | 20% |
| **Burundi** | 15% | 15% | 15% |
| **Cameroon** | 15% | 15% | 15% |
| **Cape Verde** | 20% | 20% | 20% |
| **Central African Republic** | 15% | 15% | 15% |
| **Chad** | 25% | 20% | 25% |
| **Comoros Islands** | 10% | 10% | 10% |
| **Congo (Dem. Rep.)** | 14% | 14% | 14% |
| **Djibouti** | 15% | 15% | 15% |
| **Egypt** | 20% | 20% | 20% |
| **Equatorial Guinea** | 10% | 10% | 25% |
| **Eritrea** | 10% | 10% | 10% |
| **Eswatini (formerly Swaziland)** | 15% | 15% | 15% |
| **Ethiopia** | 15% | 15% | 15% |
| **The Gambia** | 15% | 15% | 15% |
| **Ghana** | 20% | 20% | 20% |
| **Guinea** | 15% | 15% | 15% |
| **Guinea-Bissau** | 10% (not final) | **No** | 10% [80] |
| **Kenya** | 20% | 20% | 20% |
| **Lesotho** | 10% | 25% (standard) | 10% |
| **Liberia** | 15% | 15% | 15% |
| **Libya** | **0%** | **0%** | **0%** |
| **Madagascar** | 10% | 10% | 10% |
| **Malawi** | 15% generally | 15% | 15% general |
| **Mali** | 15% | 15% | 15% |
| **Mauritania** | 25% on net basis | 0% | 15% [81] |
| **Mauritius** | 10% | 0% | 10% |
| **Morocco** | 10% | 15% | 10% |
| **Mozambique** | 20% | 20% | 20% |
| **Namibia** | 10% | 10% | 10% |
| **Niger** | 16% | 16% | 16% |
| **Nigeria** | 10% | 10% | 5% |
| **Rwanda** | 15% | 15% | 15% |
| **Senegal** | 20% | 20% | 20% |
| **Seychelles** | 15% | 15% | 15% |
| **Sierra Leone** | 15% | 15% | 15% |
| **South Africa** | **Nil** | **Nil** | **Nil** |
| **South Sudan** | 15% | 15% | 15% |
| **Tanzania** | 15% | 15% | 15% |
| **Togo** | 15% | 15% | 20% |
| **Tunisia** | 15% | 15% | 15% |
| **Uganda** | 15% | 15% | 15% |
| **Zambia** | 20% | 20% | 20% |
| **Zimbabwe** | 15% | 15% | 15% |

[80] For independent professional listed services

[81] on gross basis if the provider is operating in Mauritania for less than 6 months

## APPENDIX B: BUBBLE GRAPH DEPICTING SOUTH AFRICAN EXPORT OF GOODS