An analysis of income from staking crypto assets paid to a non-resident in terms of the South African Income Tax Act No. 58 of 1962, and a tax treaty established on the OECD Model Tax Convention.

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Gloria in Excelsis Deo.

1. INTRODUCTION

1.1. Background

The global economic markets have experienced their fair share of market moving events such as Covid-19, the Russia-Ukraine war and global procurement challenges. It is interesting to realise that, through all these market moving events, the crypto industry has been around for more than a decade. The emergence of crypto assets (private digital assets that depend primarily on cryptography and distributed ledger technology for record keeping) has unleashed a plethora of financial innovation that will likely revolutionise the form of money and the ways it is used.[1]

This is partly because in the past few years crypto assets have moved from being niche products in search of a purpose to having a more mainstream presence as speculative investments, hedges against weak currencies, and potential payment instruments. The spectacular, if volatile, growth in the market capitalisation of crypto assets and their resemblance to the traditional financial system has led to increased efforts to regulate them.[2]

The adoption of crypto assets is growing in some emerging markets and developing economies as users seek ways to move away from the centralised financial system. While the market size of crypto assets may not be a financial stability risk, growing interlinkages with regulated financial services and the lack of regulation might be.[3]

Furthermore, crypto assets including 'virtual currency' had a market capitalisation of USD 346 billion as at September 2020. The crypto asset market then experienced massive growth as the market capitalisation of crypto assets reached almost USD 3 trillion in November 2021 before falling to less than USD 1 trillion in July 2022, demonstrating its relatively high volatility.[4] In 2023, the crypto asset market again experienced substantial growth, recovering from challenges faced in 2022. The total market capitalisation more than doubled, increasing from USD 829 billion to USD 1.72 trillion. Bitcoin played a significant role in this resurgence, with its price reaching USD 42 000 by the fourth quarter of 2022. The market optimism was particularly driven by the anticipation of US spot Bitcoin ETFs (an exchange traded fund that

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[1] Prasad E *The Future of Money: How the Digital Revolution is Transforming Currencies and Finance* (2021) Harvard University Press. Available at: https://www.hup.harvard.edu/books/9780674258440 (Accessed: 26 October 2023).
[2] Narain A and Moretti M "The Money Revolution" *Finance & Development* (September 2022) 59(3). *Finance & Development* 0059, 003, A000, Available at: https://doi.org/10.5089/9781513597829.022.A000.
[3] International Monetary Fund. *Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets* (2022) Fintech Note No 2022/009 available at https://www.imf.org/en/Publications/fintech-notes/Issues/2022/09/26/Regulating-the-Crypto-Ecosystem-The-Case-of-Unbacked-Crypto-Assets-523715 (Accessed: 20 October 2023).
[4] Ibid.

exposes investors to the price movement of Bitcoin), contributing to a surge in market sentiment.[5]

The Organisation for Economic Co-operation and Development ("OECD") report on taxing virtual currencies ("OECD report") notes that in some countries, there is a degree of uncertainty over how virtual currencies are defined which may result in different interpretations of the tax treatment.[6] The report notes that, because virtual currencies are generally considered to be a form of intangible property or financial assets rather than a currency for income tax purposes, normal property tax rules will apply. Accordingly, the characterisation of crypto assets is of foundational importance for understanding how they fit within existing tax systems.[7]

The term 'crypto asset' will be used throughout this research study given that it is the term used to describe digital financial assets based on distributed ledger technology and the OECD considers the term 'crypto asset' to be the common reference when describing types of digital financial assets that are based on distributed ledger technology.[8] Additionally, both the Financial Sector Conduct Authority ("FSCA")[9] and South African Revenue Service ("SARS")[10] use the term 'crypto assets'.

According to the OECD report,[11] crypto assets and their resemblance to other types of financial products or intangible assets require a sound tax policy framework to ensure the consistent treatment of similar asset types and to prevent tax avoidance. Given that crypto assets can act as investments generating value, countries will undoubtedly seek to determine how much of this value they can tax. Thus, it is with no doubt that this growing market is of keen interest to governments, regulators and tax authorities.

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[5] CoinGeko *2023 Annual Crypto Industry Report,* (2024). Available at https://coingecko.com/research/publications/2023-annual-crypto-report#read-the-report-coingecko-s-2023-annual-crypto-industry-report.

[6] OECD *Taxing Virtual Currencies: An Overview Of Tax Treatments And Emerging Tax Policy Issues* (2020) OECD, Paris. Available at: www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emergingtax-policy-issues.htm.

[7] Ibid.

[8] Ibid.

[9] Financial Sector Conduct Authority *Policy Document Supporting The Declaration Of A Crypto Asset As A Financial Product Under The Financial Advisory And Intermediary Services Act* (2022). Available at: https://www.fsca.co.za/News%20Documents/FSCA%20Press%20Release_Declaration%20of%20Crypto%20Assets%20As%20A%20Financial%20Product_20%20October%202022.pdf (Accessed: 23 October 2023).

[10] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020* (2021) at 50.

[11] OECD (2020), op cit note 6.

1.2. Decentralised Finance

Decentralised finance ("DeFi") can be considered as an alternative financial system based on blockchain and virtual currencies, using applications that aim to provide financial services. DeFi aims to democratise finance by replacing legacy centralised institutions with peer-to-peer relationships that can provide a full spectrum of financial services, from everyday banking, loans and mortgages, to complicated contractual relationships and asset trading.[12] In traditional finance, an individual can typically place their savings in an online savings account and earn, say, a 0.50 per cent interest rate. The bank will then take the money and lend that money to another customer at 3 per cent interest, making a 2.5 per cent profit in the process. The purpose and utilisation of DeFi is that people can lend their money/savings directly to others, cutting out the 2.5 per cent profit that would have been earned by the bank (as the intermediary) and earn the full 3 per cent return on their money.[13]

In the United Kingdom ("UK"), His Majesty's Revenue and Customs ("HRMC") recognises that DeFi is the term given to describe a wide range of services that are akin to traditional financial services and such services are provided using distributed ledger technology.[14] This technology is based on a decentralised database and thus does not rely on the functions of centralised intermediaries such as banks, brokerages, or traditional exchanges to offer the services. Crypto platforms operate as decentralised exchanges where users can transact with their crypto assets and typically offer services such as savings, lending, and derivatives. These platforms also offer DeFi lending services that allow users to loan out their crypto assets, either directly to other individuals ('peer-to-peer') or indirectly through the platform and receive a financial return.[15]

Furthermore, HRMC notes that DeFi now plays an interesting role based on what transactions it can generate and how the returns should be categorised. For example, a popular and fast-growing sector of DeFi is borrowing and lending platforms. In order for these platforms to execute transactions, they rely on various smart contracts[16] that can enforce the

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[12] Ibid.
[13] Forbes *What Is DeFi? Understanding Decentralized Finance* (2023). Available at: https://www.forbes.com/advisor/investing/cryptocurrency/defi-decentralized-finance/ (Accessed: 23 October 2023).
[14] HM Revenue & Customs *Call for evidence* (2023). Available at: https://www.gov.uk/government/calls-for-evidence/call-for-evidence-the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets/the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets-call-for-evidence (Accessed: 23 October 2023).
[15] Ibid.
[16] A smart contract sets out the terms of an agreement and these terms are established and executed as code running on a blockchain.

terms of the loans and distribute the returns. This return is often described by promoters and DeFi participants as 'interest'. Interest is generally understood as 'the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another'. [17] Furthermore, only a few jurisdictions consider virtual currencies to be money and thus the HRMC's view is that it may not be appropriate to classify the returns as interest for tax classification purposes.[18]

The OECD notes that DeFi Pulse (a website dedicated to analytics and rankings of DeFi protocols) estimated that on 4 September 2020, USD 8.8 billion were locked in the market – compared to USD 460 million one year before.[19] During 2022, the DeFi market had a value of USD 13.61 billion and is projected to grow at a substantial compound annual growth rate of 46.0 per cent between 2023 and 2030 which leads the OECD to note that collateralised lending is the fastest growing DeFi product, representing more than half of all crypto assets by value locked in DeFi applications.[20]

1.3. Research Objective

As the OECD Report mentions,[21] it is unclear how countries would treat the income from staking[22] crypto assets for tax purposes. Should it be considered income from a capital asset then, depending on a country's tax laws, it could conceivably be treated in the same way as traditional interest, giving rise to tax as capital income when received and to a deductible loss when paid. Given that crypto assets are becoming increasingly popular and their use in financial transactions has grown exponentially in recent years, it is important to determine how far the current tax framework stretches to account for such significant developments in the financial industry.

Thus, the classification of income from staking crypto assets (a type of DeFi transaction) within the South African ("SA") context as well as within international law will impact whether domestic withholding taxes can be applied and the allocation of taxing rights in cross-border transactions involving jurisdictions party to a tax treaty. What needs to be considered is whether

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[17] HM Revenue & Customs *Cryptoassets Manual* (2021). Available at: https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto61110 (Accessed 10 June 2024).
[18] HM Revenue & Customs *Corporate Finance Manual* (2020). Available at: https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm33030 (Accessed on 4 May 2023).
[19] OECD (2020) op cit note 6.
[20] OECD *Why Decentralised Finance (DeFi) Matters and the Policy Implications* (2022). Available at https://www.oecd.org/finance/ why-decentralised-finance-defi-matters-and-the-policy-implications.htm (Accessed on 4 May 2023).
[21] OECD (2020) op cit note 6.
[22] The definition of 'staking' is discussed in chapter 2.5 below.

the return from DeFi activities, and specifically staking activities, can potentially be classified as interest from a SA perspective and be classified as the same under tax treaties to which SA is a party.

The purpose of this research study has two objectives. The first is to explore if the return earned from staking activities can be defined as 'interest' under the Income Tax Act No. 52 of 1962 ("the Act") and the possibility of taxing the amount under the withholding tax on interest ("WTI") provisions of the Act. The second is to determine if a tax treaty based on the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital ("OECD Model")[23] can classify such amount under Article 11 and thus reduce the rate of tax which must be applied. The purpose of considering both these aspects stems from *CSARS v Van Kets*[24] where the court highlighted that tax treaty provisions rank equally and should be reconciled with the provisions of the Act so that they are read as one coherent whole. Additionally, foreign investors with a weak or passive connection to SA will typically be subject to withholding tax.[25]

In terms of the above, the dissertation aims to provide answers to the following:

- From a SA perspective, can the return from staking activities be defined as 'interest' under the Act and be subject to the WTI provisions, and
- If so, could a tax treaty based on the OECD Model also classify such a transaction under Article 11 and thus reduce the rate of which tax must be withheld?

Finally, an exemplar will be presented to provide a practical analysis of a staking transaction, which may become very prevalent in the future given the adoption of crypto assets. Ultimately, this research seeks to provide a comprehensive analysis of the classification of income from staking crypto assets under SA tax law and application of a tax treaty based on the OECD Model. By the conclusion of the research, it is anticipated that a robust understanding of the applicable taxation in SA and application of a tax treaty will emerge, allowing for informed decisions to be made regarding its implementation.

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[23] OECD *Model Tax Convention on Income and on Capital 2017* (Full Version) (2019). Paris: OECD Publishing. Available at: http://dx.doi.org/10.1787/g2g972ee-en (Accessed on 4 May 2023).
[24] *CSARS v Van Kets (2011)* 74 SATC 9 at para 25.
[25] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2010 (2010) at 69-70.

1.4. Research Method

The research will consist of a legal analysis and an exemplar. The legal analysis will deal with the application of WTI from a SA perspective and subsequently, the application of a tax treaty based on the OECD Model. This requires meaning given to certain concepts such as DeFi, interest and source which is done by investigating only textual data such as legislation and other written documents. This will be followed by an exemplar to capture the exact application of the study to a certain set of facts. Therefore, a qualitative approach was deemed necessary for this study.[26]

The research methodologies to be applied in this dissertation are derived largely from the doctrinal legal research method, given that it applies to tax law and principles that have already been established as an accepted framework and apply this to a new context.[27] The technique for doctrinal legal research is often associated with the learning or studying of legislative writings and for this reason, it is an appropriate method because the research method entails analysing and interpreting legal work such as legislative provisions and legal commentary.[28] Under the interpretivist paradigm, a qualitative approach was used in this study to address the research objectives.[29]

1.5. Limitation of scope

The scope of the research will be limited to non-residents for SA tax purposes. Furthermore, the research attempts to align traditional finance terms such as interest with that of the reward or return from DeFi transactions, specifically staking activities. The focus is to determine whether a similar traditional finance scenario of interest and debt apply to the current WTI of the Act and whether this can be applied to crypto assets and DeFi transactions.

The WTI and source provisions also include a list of specific exemptions. This involves various situations such as permanent establishment related exclusions as well as exclusions relating to banks and back-to-back loan agreements. While it may be apt to consider now or in

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[26] McKerchar MA "Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation" (2008). eJournal of Tax Research, Vol. 6, No. 1, pp. 5-22, 2008, UNSW Law Research Paper No. 2009-31, Available at SSRN: https://ssrn.com/abstract=1464141.
[27] Taekema S "Theoretical and Normative Frameworks for Legal Research: Putting Theory into Practice" (2018) L. & Method 1-17. Available at: www.lawandmethod.nl/tijdschrift/lawandmethod/2018/02/lawand method-D-17-00010 (Accessed 15 January 2023).
[28] McKerchar op cit note 26.
[29] Rossman G & Rallis S *Learning in the Field: An Introduction to Qualitative Research* (2003). Available at: https://doi.org/10.4135/9781071802694 (Accessed 15 January 2023).

the future whether crypto exchanges can meet the definition of a bank and fall within the respective legislation requirements, it will not be considered in this study.

Under SA domestic tax law, crypto assets are subject to the normal income tax rules and may be subject to capital gains tax upon disposal.[30] The facts and circumstances of the transaction need to be established in order to ascertain how the transaction will be taxed. While it is noted that there are various crypto assets transactions which will have different income tax consequences (such as capital gains), this research will focus on the return earned from staking crypto assets.

In terms of determining 'source' within the WTI provisions, the study will not fully explore how to determine source in the context of staking crypto assets. The research paper will also exclude any VAT aspects related to the return and transactions with crypto assets. However, it should be noted that various 'cryptocurrency' activities are deemed to be financial services under section 2 of the VAT Act[31] and therefore exempt from VAT in SA.

Typically, tax treaties provide relief from tax for foreign investments under Article 11 of the OECD Model, however, this is dependent on the specific tax treaty in question. Furthermore, it is recognised that tax treaties may not apply if certain anti-avoidance provisions are met. However, this research study will not further discuss the application anti-avoidance measures contained within a tax treaty.

The research will recognise that under Article 11(2) of the OECD Model, beneficial ownership is a requirement. This may be complex research topic on its own. Accordingly, it will be assumed that the taxpayer is the beneficial owner of the interest under Article 11 of the OECD Model.

The research will recognise that there is a possibility for countries to follow different approaches to tax crypto assets and thus create tax mismatches. These tax mismatches will not be further explored. Furthermore, the research will note that income can be taxed under more than one article within a tax treaty. Given the uncertainty of crypto assets and the income thereof, the research study will be limited to only exploring whether Article 11 of the OECD Model applies to the return on staking crypto assets.

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[30] South African Revenue Service *SARS's stance on the tax treatment of cryptocurrencies* (2018). Available at https://www.sars.gov.za/media-release/6-april-2018-sarss-stance-on-the-tax-treatment-of-cryptocurrencies/ (Accessed 12 February 2023).
[31] Value-Added Tax Act, No. 89 of 1991.

1.6. Structure of the dissertation

The dissertation will consist of seven chapters. Chapter 1 presents the introduction. Chapter 2 will provide the background to crypto assets and DeFi transactions. This will explore the mechanics of crypto assets, DeFi platforms and staking. Chapter 3 will review the requirements of the WTI provisions with the main focus being the definition of interest in section 24J of the Act. The chapter will explore the definition of interest and consider if, under SA domestic legislation, interest may apply to income from staking crypto assets.

Chapter 4 will analyse the definition of interest as discussed in chapter 3 against staking activities and whether the WTI provisions apply to returns from staking crypto assets. Chapter 5 will review the interpretation of terms in the tax treaty and the application of Article 11 of the OECD Model. This chapter will conclude by determining whether the WTI rate can be reduced by a tax treaty based on the OECD Model.

Chapter 6 will provide an exemplar whereby a UK individual participates in staking activities with an intermediary in SA. Based on the legal analysis dealt with in previous chapters, the exemplar will apply the findings and present a conclusion as to whether the WTI provisions can be applied and subsequently whether the SA-United Kingdom tax treaty[32] may reduce the rate of WTI. Chapter 7 will summarise the dissertation and provide conclusions and recommendations based on the analysis performed.

[32] *Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains 2003, read with the protocol of 2012 amending this agreement*, available at IBFD Tax Treaty Database by subscription, accessed on 30 March 2023 (hereinafter the SA-UK tax treaty).

2. CRYPTO ASSETS, DEFI AND STAKING

2.1. Background

This chapter provides a brief summary of the history of interest, understanding the mechanisms of the current banking system and how the use of blockchain technology is similar to the traditional financial system. Subsequently, a brief understanding of DeFi is introduced with a focus on crypto asset staking to explore the similarities to the traditional finance and which may closely resemble the nature of interest.

While this chapter does not engage in a legal analysis, it aims to provide a comprehensive background for the legal analysis that follows in the subsequent chapters. Thus, Chapter 2 explores the function and background of crypto assets and DeFi, allowing for a more focused legal analysis in Chapter 3 where the definition of interest, WTI provisions and tax implications within South African law are examined.

2.2. History of interest

The concept of saving forms part of the annual flow of goods, explained in a well-known passage that, 'what is annually saved is as regularly consumed as what is annually spent, and nearly in the same time too.'[33] In the world of economics, saving can be explained by considering the behaviour of an economic participant who saves when he chooses not to use part of his income for the purchase of consumer goods. Additionally, saving forms a key element that allows an economic system to develop.[34]

It is recognised that money (coin or paper) is merely a tool for the means of exchange and that in substance an actual loan regardless of its form, is the money's worth or the goods which the borrower can purchase. Additionally, a loan is considered an assignment, when the lender provides the borrower with capital, with the condition that interest is paid annually to the lender and at the end of the term the capital is repaid. Lastly, even though in some countries interest is illegal, money can always be used productively and thus a payment should always be made for its use.[35]

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[33] Smith A *An Inquiry into the Nature and Causes of the Wealth of Nations* (1988) at 260. Raleigh, N.C.: Generic NL Freebook Publisher. Available at: https://search-ebscohost-com.ezproxy.uct.ac.za/login.aspx?direct=true&db=nlebk&AN=1086046&site=ehost-live. (Accessed 28 September 2024).
[34] Bertocco Giancarlo "The Relationship Between Saving and Credit from a Schumpeterian Perspective." (2009) *Journal of Economic Issues*, vol. 43(3) at 607–40. Available at: http://www.jstor.org/stable/40647764. (Accessed 22 February 2024).
[35] Smith op cit note 33 at 270.

In a 2002 article, Michael Hudson explains the origins of interest bearing debt with a focus on the history of how interest came to be as we know it today.[36] Hudson notes that in order to charge interest, there must be more than what occurred in tribal practice. In tribal practice, the way debt was structured is in our modern world as social interaction among friends, family members and neighbours. Accordingly, because these debts were not commercial, there was no economic basis for charging interest on them.[37] However, from an economic perspective, Hudson states that interest is understood to form a precise fraction of the principal debt which accrues on a regular basis (periodically) and is recognised in a contract.[38] Consequences of failing to pay the interest would result in the collateral becoming due or other penalties.

Looking back at history, the point at which interest-bearing debt could be located started with the agriculture and handicraft industry. This is based on the thinking that economies evolve from the agricultural and pastoral stages of development to the industrial stage, finally reaching the commercial stage. Thus, it would imply that interest emerged as a result of productive or pastoral lending.[39] Additionally, it is noted that historically, the term interest was used in conjunction with money or other fungible items in Roman literature and is not an inherent feature of the classical *mutuum*, and thus it is hypothesised that the origins of interest lie in the concept of a delayed barter.[40]

Fritz Heichelheim also considered how the charging of interest originated.[41] The early 'food-money' can be linked to the origins of productive credit when speculating that around 5000 BC, 'Dates, olives, figs, nuts, or seeds of grain were probably lent out …to serfs, poorer farmers, and dependents, to be sown and planted, and naturally an increased portion of the harvest had to be returned in kind.'[42] In addition to fruits and seeds, 'animals could be borrowed too for a fixed time limit, the loan being repaid according to a fixed percentage from the young animals born subsequently.'[43]

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[36] Hudson M "Reconstructing the Origins of Interest-Bearing Debt" (2002). Available at: https://www.semanticscholar.org/paper/Reconstructing-the-Origins-of-Interest-Bearing-Debt-Hudson/aa0e47ac826c6022cea8b2eca976c7b0a1810d5e.
[37] Ibid.
[38] Ibid.
[39] Ibid.
[40] Kelly JM "A Hypothesis on the Origin of 'Mutuum'" (1970) 5 *Irish Jurist* 156–163. Available at: https://www.jstor.org/stable/44026567?seq=2#metadata_info_tab_contents (Accessed 14 October 2024).
[41] Heichelheim F *Ancient Economic History, from the Paleolithic Age to the Migrations of the Germanic, Slavic and Arabic Nations*. Revised ed. (1958) New York: Biblo and Tannen.
[42] Ibid. at 54.
[43] Ibid.

During these times, the wealthy or rich would own cattle, crops and seeds in excess, as a result they gave 'out their surplus stocks regularly to poorer farmers and herdsmen and gained interest in kind.'[44] Accordingly, risk and rewards are present in these types of arrangements and a higher interest rate would compensate for the risk. This already indicated that owners of these resources could adjust their interest premiums to reflect the degree of risk, he claimed, since lenders 'had to demand a higher return in view of the possible losses from bad harvests or animal diseases.'[45]

Hudson states that interest rates were denominated in barley from the middle of the third millennium. The palace would lease out the land while administrators had the right to use the land and were entitled to keep whatever amount was produced in excess of the amount stipulated by their contract with the palace. Accordingly, if the produce was less than the stipulated amount the shortfall was recorded as a debt and they were obliged to pay the difference out of their own resources. The debt formula had become well established by the end of the third millennium as the palace had debt tablets which contained information such as the sum due, due date, names of witnesses, and the interest rate to be charged (often to accrue only in the event that the debt was not paid in a timely fashion).[46]

In summary, there is evidence that historically debts or loans have been recognised in the context of both money and other forms of capital. Nevertheless, the debt exists where a borrower has been provided capital by the lender with acknowledgment that the capital must be repaid. In return for the use of the capital, interest is charged, typically as a portion of the original capital. The rate of the interest is determined by the risk and reward between the borrower and lender.

2.3. The banking system

The understanding of bank deposits can be explored in a statement as, 'The banker was a man or a collection of men who under-took to keep money safely for its owners until they wanted it, and who made the business pay by lending out a good deal of this money to other people who wanted temporary loans.' [47] It can be further observed that the Political Dictionary of 1845 says,

[44] Ibid.
[45] Ibid.
[46] Hudson op cit note 36.
[47] Cannan E "The Meaning of Bank Deposits." (1921) *Economica*, no. 1, at 28–36. Available at: https://doi.org/10.2307/2548502. (Accessed 22 February 2024).

> *'People may deposit small sums of money at a bank, which the banker lends. Thus, a bank is a means of facilitating the loan of money from the possessor of money to the farmer or manufacturer who has goods but wants ready money. The lending of money is the operation of banking, and a bank is a centre which facilitates this lending; it enables people to lend through a banker and his connection, who could not lend without that.'*[48]

Edwin Cannan tries not to complicate the words by mentioning that the nature of banking is nothing too mysterious. The term deposit in the banking context uses the verb function to describe '…the action of placing an article with some person or institution for safe custody.'[49] He explains that our expectation for a deposit is that we place things in safe custody with a person with the expectation to receive back that exact same thing. If, however, that thing has been used by the person, it cannot be a deposit but must rather be considered to be lent.[50]

Within the banking context, the banks' customers are both lenders and borrowers and that the bank is in fact an intermediary who arranges for the capital of the lenders to be used by the borrowers.[51] Thus, a key element of the traditional finance system is that of intermediaries such as banks who are required for transactions to flow. Lastly, for banks, the traditional manner of making money is by offering transaction services and earning a profit by taking deposits and lending those funds to business customers at higher interest rates.[52]

2.4. Blockchain technology and DeFi

In layman's terms, blockchain is a data structure that stores transactional records while also ensuring security, transparency, and decentralisation. Each transaction on the blockchain is secured with a digital signature which proves the transaction's authenticity. In a blockchain, the recorded data is tamper-proof and cannot be changed as it uses encryption and digital signatures. Blockchain technology can increase the efficiency of clearing and settlement of financial assets after transactions, while reducing costs. This resolves several existing problems in the banking industry to a large extent. Blockchain technology can also reduce the role of manual interventions and digitise procedures that are currently paper based in the finance industry. Simply, blockchain technology allows transactions to occur simply, safely, effectively, and also safely.[53]

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[48] Ibid.
[49] Ibid.
[50] Ibid.
[51] Ibid.
[52] DeYoung R and Rice T "How do banks make money? A variety of business strategies" (2004) Economic Perspectives-Federal Reserve Bank of Chicago, 28(4) at 52-67.
[53] Chowdhury M, Suchana K, Alam S & Khan M "Blockchain Application in Banking System" *Journal of Software Engineering and Applications* 14 298-311. Available at: https://doi.org/10.4236/jsea.2021.147018.

A further benefit of blockchain technology is the use of smart contracts which can allow for payments to execute automatically once the predetermined conditions are reached. The smart contract facilitates the sharing of contractual information on a decentralised distributed ledger between the supplier and buyer. Banks can also use smart contracts to execute contracts they have with various parties.[54]

2.4.1. How does blockchain work?

All crypto asset transactions are recorded in a decentralised public ledger using blockchain technology.[55] For a transaction to complete within the blockchain, an authentication is required, then a block with the information of the transaction is created. A node is a computer that is connected to a blockchain network and the node acts as a gateway that allows a user to transact on the network and each node works together to validate transactions. Then the created block is sent to every participant in a blockchain. The participants then validate the transaction. If the information of the newly created block is wrong or altered, then it will not match with other blocks of the nodes in the blockchain. The validation then will fail, and the transaction will not be recorded. If validation is passed, then the transaction is complete.[56]

Similar to traditional finance where customers have a bank account number, with blockchain, a user's private key enables them to transfer crypto assets from their own wallet to the address represented by another user's public key.[57] However, a difference from traditional finance arises due to users' personal details not being recorded on the blockchain and thus making it "pseudonymous".[58]

2.4.2. What is DeFi?

The term 'DeFi' stands for decentralised finance and describes a finance ecosystem that allows for consumers to transfer, trade, borrow and lend crypto asset on a decentralised blockchain.[59] This all takes place outside of the traditional financial structure and regulators and operates

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[54] Guo Y & Liang C "Blockchain application and outlook in the banking industry" (2016) *Financ Innov* 2, 24. Available at: https://doi.org/10.1186/s40854-016-0034-9 (Accessed 20 March 2024).
[55] Baros CR "Barter, Bearer, and Bitcoin: The Likely Future of Stateless Virtual Money" (2014) 23 *University of Miami Business Law Review* 1.
[56] Chowdhury op cit note 53.
[57] Herbert J & Stabauer M "Bitcoin & Co: An Ontology for Categorising Cryptocurrencies" (2017) *Intl. J. Multidisciplinarity Bus. & Sci* 3.
[58] Iansiti M & Lakhani KR "The Truth About Blockchain" (2017) *Harvard Bus. Rev*. Available at https://hbr.org/2017/01/the-truthabout-blockchain (Accessed 22 May 2023).
[59] Livni E & Lipton E "Crypto Banking and Decentralized Finance, Explained" *The New York Times* (5 September 2021). Available at: https://www.nytimes.com/2021/09/05/us/politics/cryptocurrency-explainer.html (Accessed 20 March 2024).

without involving any third-party or central administration.[60] With the use of blockchain technology, the DeFi ecosystem is a financial market that is computer-controlled and automatically executes transactions such as providing loans or paying income (like interest) to users. Within DeFi, users can be matched via peer-to-peer mechanisms,[61] or on platforms where they gain access to pooled funds from lenders which can be made available for the user to borrow.[62]

DeFi platforms are structured to be independent from their developers and funders, as the purpose of being decentralised is to ultimately be governed by a community of users whose power comes from holding the protocol's tokens. On the other hand, a centralised finance platform will entail a customer dealing directly with a company that will share information of the customer with the relevant regulators.[63]

Within traditional finance, there lies a series of intermediaries that connect market participants.[64] These intermediaries bring together a range of financial market participants, in particular those who can provide financial resources (savers, lenders, and investors) and those who seek financial resources (for example borrowers, entrepreneurs etc). DeFi emerges from important patterns in technological evolution which can be described as Moore's law and Kryder's law. Moore's law refers to the assumption that the amount of data processing power grows exponentially while Kryder's law suggests the same for data storage capacity. The combination of these ultimately leads to a decrease in costs.[65]

The OECD notes that collateralised lending (DeFi lending that requires collateral from the borrower) is the fastest growing DeFi product, representing more than half of all crypto assets by value locked in DeFi applications.[66] This allows for lenders to earn a return for depositing into a DeFi protocol and for the borrowers (who provide collateral) to retain

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[60] Das VK 'DeFi Lending- A Comprehensive Guide' (14 August 2020). Available at: https://www.blockchain-council.org/defi/defi-lending-a-comprehensive-guide/. (Accessed 26 May 2024).
[61] Yang Jet al "A Survey on Blockchain: Architecture, Applications, Challenges, and Future Trends" (2020) in *2020 International Conferences on Internet of Things (IThings) and IEEE Green Computing and Communications (GreenCom) and IEEE Cyber, Physical and Social Computing (CPSCom) and IEEE Smart Data (SmartData) and IEEE Congress on Cybermatics (Cybermatics)*. Available at www.researchgate.net/publica tion/348095621_A_Survey_on_Blockchain_Architecture_Applica tions_Challenges_and_Future_Trends (Accessed 26 May 2024).
[62] Gudgeon L et al "DeFi Protocols for Loanable Funds" (2020) Proceedings of the 2nd ACM Conference on Advances in Financial Technologies. Available at: https://dl.acm.org/doi/10.1145/3419614.3423254 (Accessed 26 May 2024).
[63] Livni op cit note 59.
[64] Zetzsche DA, Arner DW & Buckley RP "Decentralized Finance" (2020) 6 *Financ. Regul*. 172–203. Available at: https://academic.oup.com/jfr/article/6/2/172/5913239 (Accessed 26 May 2024).
[65] Ibid.
[66] OECD (2022) op cit note 20.

exposure of their crypto assets and benefit from future changes in the value of those crypto assets while simultaneously gaining access to liquidity.[67]

2.5. Staking

While there are various transactions that can occur under the DeFi term, the focus of this study is the DeFi activity known as staking. In simple terms, staking refers to the process of holding a certain amount of crypto assets and allocating the amount to support a specific network.[68] This is done by a mechanism called Proof of Stake ("PoS") which ensures that all transactions are verified and secured by the nodes on the blockchain. In return for allocating crypto assets and allowing the network to verify the transaction, the node will receive a return.[69] The node may represent one user or even a staking pool which has a group of users who pool their crypto assets.[70] The more crypto has been staked, the more likely the odds are that they will be selected to validate a transaction. Staking ensures the stability and security of a PoS blockchain, as validators risk losing the crypto assets they have locked in the staking contract if they attempt to behave dishonestly by validating false transactions.[71]

The possibility for this arises due to the fact that crypto assets is decentralised and does not require an intermediary such as a bank to process the transaction. Rather, by using the PoS mechanism the stakers who stake their crypto asset now ensure transactions are verified and secure and will receive a return. Additionally, it should be noted that when staking crypto assets users cannot trade the crypto as it has been locked up or vested to support the blockchain for that period.[72]

In terms of rewards for staking, the rewards are usually described in terms of annual percentage yield and each token has its own rewards structure. After validation of a crypto transaction has been completed, the delegator is eligible to earn a reward and the service typically defines the waiting period required to receive it.

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[67] Ibid.
[68] Banerjee A "Staking vs Yield Farming vs Liquidity Mining- What's The Difference? [UPDATED]" (30 November 2023). Available at: https://www.blockchain-council.org/defi/staking-vs-yield-farming-vs-liquidity-mining/.
[69] Coinbase "What is Staking?". Available at: https://www.coinbase.com/learn/crypto-basics/what-is-staking.
[70] Utimaco "What are the Types of Nodes in Blockchain?". Available at: https://utimaco.com/service/knowledge-base/blockchain/what-are-the-types-of-nodes-in-blockchain#:~:text=Staking%20Nodes&text=A%20Staking%20Node%20may%20consist,being%20selected%20to%20confirm%20blocks.
[71] Ibid.
[72] Ibid.

2.5.1. Direct vs Indirect Staking

There are two methods to conducting staking, namely direct and indirect staking. In terms of direct staking, as it suggests the user will allocate and lock up their crypto asset to the blockchain network without the use of an intermediary. This typically occurs where a node stakes crypto assets and once allocated to the blockchain they can operate as validators to validate transactions on the blockchain.[73] It should be noted that direct staking and being a validator to the blockchain requires some technical skill and capital investment for the infrastructure setup (computer knowledge and computing power which involves various hardware items). Thus, some users may not have the skill or resources and prefer to delegate their stake to one of the active validators of the network and obtain part of their reward.[74]

This is where indirect staking, otherwise known as 'staking by delegation', finds application as users do not directly participate in the staking activity but rather stake their crypto assets by joining a staking pool run by another party acting as an intermediary.[75] Indirect staking is currently the most common form of staking. This is because several crypto exchanges that operate as intermediaries offer their resources and infrastructure to their users as part of a staking service and will earn rewards on behalf of their users.[76]

By removing the intermediary and applying blockchain technology under the DeFi spectrum, staking acts in a very similar way to traditional finance. While the purpose of staking is to validate transactions on the PoS network, the income earned from indirect and direct staking may differ. With indirect staking there is a resemblance to the current traditional financial method of earning interest on a savings account as the user still makes use of an intermediary who in turn use their skill and capital to generate returns for the user and allowing the user to earn a return.

However, in direct staking, the user effectively steps into the position of the intermediary. The user employs their own skill and resources to stake and to help validate transactions on the

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[73] Oderbolz N, Marosvölgyi B & Hafner M "The Economics of Crypto Staking" (2023) Center for Cryptoeconomics c/o Swiss Economics. Available at: https://cryptecon.org/blog-en/items/theeconomics-of-crypto-staking.html (Accessed 15 November 2023).
[74] Gersbach H, Mamageishvili A & Schneider M "Staking Pools on Blockchains" (2022). Available at: https://arxiv.org/abs/2203.05838 (Accessed 15 November 2023).
[75] Cong LW, He Z & Tang K "Staking, Token Pricing, and Crypto Carry" (2022). Available at: https://ssrn.com/abstract=4059460 (Accessed 15 November 2023).
[76] Lehmann M, Krysa F, Prévost E, Schinerl F & Vogelauer R "Staking Your Crypto: What are the Stakes?" (2023) 9–10. Available at: https://ssrn.com/abstract=4339687 (Accessed 15 November 2023).

network. In comparison, while the direct staker earns rewards for validating transactions, the indirect staker shares in the rewards of the intermediary who validates the transactions.

Thus, in substance, the income from indirect staking is more passive in nature as it still requires an intermediary to use their skill and resources to produce the income, whereas direct staking is comparable to transaction fees earned by banks for providing customers bank accounts and allowing them to transact for a fee all by using their own skill and resources.

2.5.2. Conclusion

While the return from staking crypto assets and interest are related concepts, they are not exactly the same. Staking involves holding a certain amount of crypto assets in a wallet to support the network's operations and earn rewards in return. However, this can be done in a direct and indirect manner. Indirect staking is the most common form of staking which makes use of intermediaries to perform the staking, and the users share in the returns generated. This makes indirect staking a more passive activity as the user delegates the actual staking activity to the intermediary who then performs the actual staking. When compared to traditional finance, this would be similar to banks (intermediary) providing customers with access to savings accounts that earn interest. The intermediary uses the customer funds to lend the funds out at a higher interest rate to businesses and other individuals.

Whereas direct staking is more active, and the user must commit their own skill and resources to ensure the nodes validate transactions on the network. The substance and purpose of direct staking resembles a fee earned for providing services (securing and validating the network) similar to what an intermediary such as a bank would also earn.

3. REQUIREMENTS FOR WTI UNDER SOUTH AFRICAN LAW

This chapter considers the requirements for the WTI provisions to apply and will mainly focus on the interest definition in terms of the SA tax law. If interest is being paid from a SA source to a non-resident, the WTI provisions state that SA may apply a withholding tax on such interest payment to the non-resident.

3.1. WTI provisions

A withholding tax is used as a mechanism to enable the collection of taxes from non-residents. This means that a resident payer has the obligation to withhold a certain percentage of tax from payments made to a non-resident.[77]

In 2010, National Treasury proposed that in order to align with global tax practise, the cross-border interest exemption should be narrowed and thus implement withholding tax on interest.[78] It should be noted that the interest exemption mechanism at that time used a blanket interest exemption which did not achieve a fair balance between the attraction of foreign debt capital and the need to protect the tax base against potential erosion.[79]

Effective from 1 March 2015, the Taxation Laws Amendment Act 31 of 2013 amended the Act by the insertion of Part IVB in Chapter II of Act 58 of 1962, to introduce sections 50A to 50H as WTI. Section 50B provides for the levying of a final withholding tax on interest, at a rate of 15 per cent on the amount of any interest paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received or accrued from a source within the Republic in terms of section 9(2)(*b*).[80] What is important to note is that a "foreign person" means any person that is not a resident and that if the source of the interest does not arise from within SA, then WTI is not applicable.

Where SA has a tax treaty with another country, section 50E (3) of the Act allows the rate at which the WTI applies (15 per cent) to be reduced or eliminated in terms of a double tax treaty. Thus, if interest is sourced within the Republic, and paid to a non-resident, such interest will be taxed in SA in line with the WTI provisions and may be reduced under a tax treaty. In terms of international tax law, interest is a specific type of income which is dedicated

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[77] Davis Tax Committee "Second and final report on base erosion and profit shifting for the minister of finance" (2016). Available at: http://www.taxcom.org. za/library.html (viewed 12 May 2023).
[78] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill,* 2011 (2012) at 119.
[79] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2010 (2010) at 69.
[80] Davis Tax Committee (2016) op cit note 77.

to Article 11 in both the OECD Model[81] and UN Model Double Taxation Convention between Developed and Developing Countries. In terms of the OECD Model, interest income is taxable in the country of the taxpayer's residence, while the country of source has limited additional taxing rights.

3.2. The definition of interest under SA tax law

Under section 50B of the Act, the WTI applies to the amount '….of any interest that is paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received or accrued from a source within the Republic in terms of section 9(2)(*b*).' The focus areas of this provision to consider is, the definition of "any interest", "paid by" and "from a source within the Republic in terms of section 9(2)(*b*)".

It should be noted that section 50A defines the term 'interest' to mean interest as per the definition found in section 24J of the Act.[82] Accordingly, the definition of interest under section 24J must be considered to determine whether it can apply to the return from staking crypto assets in the context of the WTI provisions.

3.2.1. Statutory definition of interest

Generally, income is taxed under the 'gross income' definition of the Act. This definition does not contain a specific inclusion for interest. However, under section 24J(3) of the Act, an amount of interest is calculated and included in the gross income of that person for that year of assessment. Additionally, the inclusion of interest in a taxpayer's gross income is accepted as 'Interest is the fruit of a capital sum invested and is, therefore, of a revenue nature'.[83]

The word "interest" is defined in section 24J of the Act as:

'interest' includes the—

(a) gross amount of any interest or similar finance charges, discount or premium payable or receivable in terms of or in respect of a financial arrangement;

(b) amount (or portion thereof) payable by a borrower to the lender in terms of any lending arrangement as represents compensation for any amount to which the lender would, but for such lending arrangement, have been entitled; and

(c) absolute value of the difference between all amounts receivable and payable by a person in terms of a sale and leaseback arrangement as contemplated in section 23G throughout the full term of such arrangement, to which such person is a party,

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[81] OECD (2019) op cit note 23.

[82] See National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2015 (2015) at 55.

[83] Haupt P & Haupt E *Notes on South African Income Tax* (41 ed. 2022) 53.

irrespective of whether such amount is—

(i) calculated with reference to a fixed rate of interest or a variable rate of interest; or

(ii) payable or receivable as a lump sum or in unequal instalments during the term of the financial arrangement;'

From the above, part (a) is considered the general application of the definition, while part (b) and (c) deal with lending arrangements and sale-and-leaseback transactions respectively. Considering part (a) above, focus is placed on the terms 'interest or similar finance charges' as well as 'in respect of a financial arrangement' which are explored in sub-sections below.

Furthermore, part (b) does not use the word interest as in part (a), rather, it is more contractually structured to include any amount in terms of a lending arrangement between a lender and borrower. A 'lending arrangement' is defined in the Act under section 24J as:

'any arrangement or agreement in terms of which—

(a) a person (in this section referred to as the lender) lends any instrument to another person (in this section referred to as the borrower); and

(b) the borrower in return undertakes to return any instrument of the same kind and of the same or equivalent quantity and quality to the lender;'

Thus, part (b) requires a lender and borrower to have an agreement where the lender lends an instrument to the borrower and the borrower returns the same instrument or equivalent quality and quantity to the lender (the lending arrangement). However, part (b) of the definition makes no reference to money and is focused on the contractual arrangement between a lender and borrower in a lending arrangement.

Interestingly, no refence is made to the type of debt i.e. a monetary loan within the interest definition and section 24J(10) of the Act recognises that 'Any reference in this section to any payment made or an amount paid…, shall be construed as including a payment or an amount or consideration other than in cash.' From this it is understood that any reference to the form of payment throughout section 24J shall be seen to include payments or consideration made in cash or consideration other than cash. However, there is also no mention of the type of debt or if the principal can be in cash or something other than cash.

3.2.2. Similar finance charges

Under part (a) it is interesting to note that the word interest is followed by an alternative, being 'similar finance charges'. The phrase 'related finance charges' was considered in *CSARS v*

South African Custodial Services (Pty) Ltd[84] which dealt with the now repealed section 11(bA)[85] and the court held that the various fees associated with the raising of the loans qualified as 'related finance charges' because of '…their close connection to the obtaining of the loans and the furtherance of SACS projects' and were therefore deductible under section 11(bA).[86]

It is noted that prior to 19 January 2017, the term used was 'related' and this was subsequently changed to 'similar' which now clarifies that it is intended to apply to finance charges of the same kind or nature to that of interest.[87] Given that 'similar finance charges' is not defined, it will take the normal meaning, which is any kind of charge levied, irrespective of name, with the intention, and having the effect, of raising the effective interest burden on the transaction as a whole.[88] This is also confirmed in the Explanatory Memorandum which stated that the "…word "similar" to clarifies (sic) the policy position that this applies to finance charges of the same kind or nature."[89] Furthermore, the term 'similar' requires more than the 'close connection' (as mentioned in *CSARS v South African Custodial Services (Pty) Ltd*) and the charge must, in substance, be similar in nature to interest.

3.2.3. Financial arrangement

While the term 'financial arrangement' is not defined in the Act and no case law is present, it will take the normal meaning of a contractual arrangement involving finance or credit of some kind.[90] While this is a very open and wide definition, one can consider the term 'financial instrument' which is defined in section 1 of the Act to include:

> *'(a) a loan, advance, debt, bond, debenture, bill, share, promissory note, banker's acceptance, negotiable certificate of deposit, deposit with a financial institution…*
>
> …
>
> *(d) any interest-bearing arrangement*
>
> *(e) any financial arrangement based on or determined with reference to the time value of money or cash flow or the exchange or transfer of an asset; and*

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[84] *CSARS v South African Custodial Services (Pty) Ltd* 2012 (1) SA (522) SCA; 74 SATC 61.
[85] Section 11(bA) was repealed with effect from 1 January 2012 and is not applicable to years of assessment commencing on or after that date. The *Explanatory Memorandum on the Taxation Laws Amendment Bill 17B of 2011* explained that section 11(bA) was obsolete in light of section 11A.
[86] *CSARS v South African Custodial Services (Pty) Ltd* 74 SATC 61 at 74.
[87] Davis D, Olivier L & Urquhart G (founding eds) *Juta's Income Tax.* Available at: https://jutastat-juta-co-za.ezproxy.uct.ac.za/nxt/gateway.dll?f=templates&fn=default.htm (Accessed 12 August 2023).
[88] Ibid.
[89] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill 17B*, 2016 (2016) at 90.
[90] Davis op cit note 87.

(f) any crypto asset'

It is noted that the term 'crypto asset' was added under the definition of 'financial instrument' in section 1 of the Act in 2021.[91] The term specifically deleted the word 'cryptocurrency' and in line with the proposed adoption of a uniform definition within the SA regulatory framework, added the so-called uniform term 'crypto asset'.

A financial arrangement has reference to the term 'financial' which is defined by the online *Cambridge Dictionary* as "relating to money or how money is managed".[92] Crypto assets are not considered as money;[93] however, it should be noted that the term 'any crypto asset' is defined as a financial instrument under section 1 of the Act which may suggest that a financial arrangement can also exist where a crypto asset is involved. Additionally, the term 'crypto asset' is used to describe digital financial assets based on distributed ledger technology[94] and again may indicate that a financial arrangement can exist in terms of a crypto asset.

In summary, the definition of 'financial instrument' includes both a 'financial arrangement' and 'any crypto asset'. However, the WTI provisions refer to a 'financial arrangement' which under its normal meaning involves a contractual arrangement of finance or credit. The term 'crypto asset' is then on an equal footing with a 'financial arrangement' as both are considered to be 'financial instruments'. Additionally, the term 'financial arrangement' has the normal meaning of a contractual arrangement that involves finance or credit. Similarly, DeFi activities such as staking crypto assets may involve a contractual arrangement which includes elements of finance or credit, supporting the view that a 'crypto asset' could qualify as a 'financial arrangement'.

3.2.4. Common law definition

As mentioned, the definition of interest under section 50A of the Act is defined to mean interest as per the definition found in section 24J of the Act. While section 24J provides the statutory definition of interest, further clarification on the interpretation of the term can be considered in

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[91] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2020 (2021) at 50.
[92] Cambridge Dictionary "Definition of 'financial". Available at: https://dictionary.cambridge.org/dictionary/english/financial.
[93] Intergovermental Fintech Working Group "Crypto Assets Regulatory Working Group Position Paper on Crypto Assets" (2021). Available at: https://www.fic.gov.za/Documents/171002_FICGuidance.Note07.pdf (Accessed 5 May 2023). See also https://www.resbank.co.za/en/home/quick-links/frequently-asked-questions#:~:text=Crypto %20assets %20are %20not %20legal,the %20value %20of %20crypto %20assets.
[94] Ibid.

case law. When seeking further interpretation and analysing terms, a purposive approach is taken, which as per M Wallis,[95] is how other courts and South African courts should approach interpretation.[96] Wallis discusses that applying context does not '….involve guesswork as to the intention of the legislature, but a reasoned assessment of the broad purpose underlying its enactment.' Thus, one cannot say that the intention of tax law is to raise revenue for a country and when interpreting, 'a construction favourable to the revenue must be given because the purpose of the statute is to raise revenue.' Rather, the approach formulated by the Supreme Court of Appeal in *Natal Joint Municipal Pension Fund v. Endumeni Municipality* 2012 4 SA 593 (SCA), must be followed where it was stated that:

> *'…consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors.'*[97]

The understanding of interest is that the amount is paid as compensation for the lender that could be seen to represent the profit if the lender '…had the use of the money, or, conversely, the loss he suffered because he had not that use. The general idea is that he is entitled to compensation for that deprivation.'[98] While the *Linton v Corser* case deals with *mora* interest, the court noted that '…interest is the life-blood of finance' and also recognises that the law needs to adapt to the role that interest plays in modern times.[99] Furthermore, where there is a default, it would almost invariably deprive the creditor of the productive use of the money and thereby cause a loss. The definition of interest was also considered in *ITC 1496* where Melamet J stated that 'Interest is an expense to compensate a lender for the time period during which the money is lent to a second party.'[100]

This view was echoed in *CIR v Genn & Co (Pty) Ltd*[101] which also noted that while interest is typically associated with monetary loans, the underlying principle is that it compensates for the use of capital and that when borrowing an asset there is an obligation to return the same asset. This suggests that interest need not only arise from monetary loans, such

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[95] Wallis M "Interpretation Before and After Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 4 SA 593 (SCA)" (2019) PER / PELJ (22). Available at: http://dx.doi.org/10.17159/1727-3781/2019/v22i0a7416 (Accessed 12 March 2023).
[96] New Zealand, Singapore, Malaysia and Hong Kong follow a purposive approach to interpretation of statutes.
[97] *Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) at 18.
[98] *Riches v Westminster Bank Ltd* [1947] 1 All ER 469 at 472.
[99] *Linton v Corser* 1952 (3) SA 685 (A) at 695. This was also supported in *Land and Agricultural Development Bank of South Africa v Ryton Estates (Pty) Ltd* [2013] ZASCA 105 at 13.
[100] *ITC 1496* (1991) 53 SATC 229 at 249.
[101] *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* 20 SATC 113 (1955) at 119 and 123.

as when the definition of interest was given a more extensive definition in *Cactus Investments (Pty) Ltd v CIR*[102] to mean something more than a consideration for deprivation but a stipulated return for the advancement of credit. In this regard (a wider definition of interest not just in respect of money), the outcomes of the *CIR v Lever Brothers & Unilever* case should be noted.[103] The judge provided an example by comparing the rental of property (one party provides the use of property and the other makes periodically payment for such use),[104] to a loan of money whereby

> *'…the lender gives the money to the borrower, who in return incurs an obligation to repay the same amount of money at some future time and if the loan is one which bears interest, he also incurs an obligation to pay that interest. Though I use the words "gives the money" this must not be taken literally as the usual way of making a loan. As a rule the lender either gives credit to the borrower or transfers to him certain rights of obtaining credit which had previously belonged to the lender, and this supply of credit is the service which the lender performs for the borrower, in return for which the borrower pays him interest.'* [105]

Similarly, in *Commissioner for Inland Revenue v Allied Building Society,*[106] the case emphasised that interest is akin to rent for the use of an asset. Said otherwise in *ITC 1124* that interest is similar to the payment for the use of money, the same way as rent is a payment for the use of an asset.[107] However, this comparison may also indicate that the amount is considered as gross income[108] for the taxpayer rather than interest but nevertheless provides a principle of what can be considered as interest.

This suggests that if a non-monetary asset were used in a manner similar to borrowed money, it could theoretically generate an "interest-like" charge. Commentary suggests that in some instances interest can be regarded as the return an investor expects for their investment, and that if such interpretation is applied, it will be very difficult, if not impossible, to argue that an amount received in addition to the repayment of the capital amount invested is not interest.[109] It should be noted that at the time of the *Cactus Investments (Pty) Ltd v CIR*[110] case, the section 24J definitions had already been added, thus, while the Act contains a definition for 'interest'

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[102] *Cactus Investments (Pty) Ltd v CIR* (61 SATC 43) at 46.
[103] *Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd* 1946 AD 441 14 SATC 1.
[104] Ibid at 10.
[105] Ibid at 11.
[106] *Commissioner for Inland Revenue v Allied Building Society* [1963] 4 All SA 218 (A) at 226.
[107] *ITC 1124* (1968) 31 SATC 53 (T) at 56.
[108] 'gross income' definition under s1 of the Act.
[109] Davis op cit note 87.
[110] See *Cactus Investments (Pty) Ltd v CIR* 1999 (61 SATC 43) at 5 where the court noted that the common law definition of interest meaning compensation for the use of money cannot always be applied.

it still may be appropriate, based on the facts and circumstances, to apply such a common law interpretation.

While many of these cases disputed interest, they largely deal with the context of borrowing of money and whether taxpayers could get a deduction. However, no case makes specific reference to interest arising exclusively on the borrowing of money or currency and in some cases provide examples to illustrate the concept of interest and its purpose. Thus, while no case has dealt with interest arising otherwise than from money it does allow the possibility that the underlying principle of interest can be applied to amounts other than money, cash or currency. Lastly, no case has specifically dealt with the application of the WTI provisions.

In summary, the common law principle and understanding of interest is compensation for the advancement of credit.[111] However, part (a) and part (b) of the interest definition already provide a wide definition of amounts that can be defined as interest and more specifically, part (b) of the definition is resembled in the cases when indicating that the borrower returns the same asset that was lent by the lender.

3.3. Paid by

The second part of the WTI provisions to consider is that the interest must be paid by any person. The amount of interest can be paid in various ways which may include cash or, if the creditor agrees, payment can be made in kind or even a form of set-off.[112] However, it is important to note that the WTI provisions are triggered when the amount is paid and not when there is only an accrual.[113]

While the WTI provisions do not clarify the withholding obligation in the case of an intermediary, reference can be made to the obligation of withholding in the case of dividends tax where the regulated intermediary must withhold dividends tax from the payment of that dividend to the beneficial owner.[114] Additionally, the UK has similar wording to that of the SA WTI provisions and the HRMC clarifies that where the interest payments are processed through various pass-through entities, the requirement to withhold tax only rests on one flow-through

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[111] Merriam-Webster "Definition of credit" 2c defined as the provision of money, goods, or services with the expectation of future payment. Available at: https://www.merriam-webster.com/dictionary/credit#dictionary-entry-1.
[112] See *ITC 1688 (1999)* 62 SATC 478 (N) at 41. Although the case relates to whether a dividend was "paid" for purposes of secondary tax on companies (since repealed), the principles regarding payment apply when considering when interest will be considered "paid" for purposes of withholding tax on interest.
[113] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2011 (2012) at 114.
[114] Section 64G(2)(c) of the Act.

entity. This will be the last UK-resident entity in the flow-through chain that transfers the interest payment to the foreign person entitled to the interest.[115] It has also been considered that the person who is seen as the last client-facing entity or intermediary is in a position to determine whether withholding obligation applies to them and therefore withhold the tax.[116]

3.4. Source

Previously, SA had established its interest source rules through common law which follows the doctrine of originating cause[117] for interest as the supply of credit and the location of the originating cause is the place where that credit is supplied.[118] However, the source rules changed to be more aligned with OECD Model tax principles.[119]

Accordingly, the source rule for interest is contained within section 9(2)(*b*)(*ii*) of the Act, where interest is deemed to be from a SA source for the non-resident in respect of the utilisation or application in SA by any person of any funds or credit in terms of any form of interest-bearing arrangement.

Additionally, a tax treaty may contain 'deemed source' rules for determining the source of certain items of income, in which case the outcome from applying these rules is applied for the purposes of the Act as a whole.[120] Therefore, if the outcome of the application of the deemed source rules in a tax treaty is that the source of a particular amount is different to the position reached when applying section 9 and common law principles, the deemed tax treaty source rules will apply.[121]

3.5. Conclusion on the definition of interest under SA tax law

Under the SA WTI provisions, the term interest is defined to mean interest as defined in section 24J of the Act. While there are three parts to the interest definition, only two main parts are relevant for this analysis. The general application under part (a) of the section 24J definition is

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[115] HMRC (United Kingdom) "SAIM 9078 – Deduction of tax: Yearly interest: The person by or through whom payment is made" (2016). Available at: https://www.gov.uk/hmrc-internal-manuals/savings-and-investment-manual/saim9078 (Accessed 12 August 2023).
[116] Bornman M, Horn C & Barnard L "Withholding tax on interest: Who has the withholding obligation?" (2019) 12(1) *Journal of Economic and Financial Sciences* a473. https:// doi.org/10.4102/jef. v12i1.473.
[117] *Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd* 1946 AD 441 14 SATC 1 at 449-450.
[118] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2011 (2012) at 97.
[119] Ibid at 98 and 100. The 2011 amendments to the source rules interest were aligned with the OECD model tax treaty principles, and thus, interest will be sourced in South Africa if (i) paid by a South African resident, or (2) if the interest is derived from use or application in South Africa.
[120] For example, Article 11(5) of the *Agreement between the Republic of South Africa and the Republic of Namibia for the Avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains 1999,* available at IBFD Tax Treaty Database by subscription.
[121] South African Revenue Service *Interpretation Note 18 Issue 5* (2022) at 22.

that the amount is either interest or similar finance charges and be in respect of a financial arrangement, which has a general meaning of a contractual arrangement of finance or credit but, when considered with the term 'financial instrument', may also arise from a contractual arrangement with crypto assets. The term 'similar finance charges' will include any amounts that are, in substance, the same kind or nature as interest.

The common law understanding of interest is that 'Interest is an expense to compensate a lender for the time period during which the money is lent to a second party.'[122] However, while the definition was made in reference to money, it was also expanded that the underlying principle is consideration for the advancement of credit.[123] Thus, the possibility exists that under part (a) of the interest definition of section 24J, interest can arise from something other than money. Additionally, section 24J(10) of the Act recognises that interest shall be seen to include payments or consideration made in cash or consideration other than cash.

Under part (b), being the more contractual definition, interest can represent an amount which is compensation for the lender paid by the borrower under a lending arrangement. Thus, part (a) seems to suggest the more commonly known form of interest from a monetary loan should be applied, however, the amount must be in respect of a 'financial arrangement' which seems to possibly encompass a contractual arrangement in the context of crypto assets. Furthermore, part (b) of the definition makes no reference to money and is focused on the contractual arrangement (lending arrangement) between a lender and borrower where the borrower agrees to return the same kind of instrument to the lender. Thus, it seems likely that in the context of crypto assets, the amount may be considered as interest under both parts and thus should find application under at least part (a) or (b).

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[122] *ITC 1496* (1991) 53 SATC 229 at 249.
[123] *Cactus Investments (Pty) Ltd v CIR* (61 SATC 43) at 46.

4. CRYPTO ASSETS IN SOUTH AFRICA

Following the analysis of the WTI provisions and definition of interest above, this section will explore the WTI provisions and crypto assets from a SA tax perspective. The objective is to determine whether the WTI provisions can apply to the return generated from staking crypto assets.

4.1. Introduction

On 20 October 2022, the FSCA declared crypto assets as financial products.[124] The effect of this statement now means that crypto assets can be regulated under the FSCA and that crypto service providers in SA must obtain a licence as a financial service provider.

In the FSCA policy document supporting the declaration of crypto assets as financial products, the FSCA states that it had identified numerous similarities between crypto assets and traditional financial products. The FSCA notes that the way in which certain crypto assets are utilised is similar to how certain traditional financial products are used. Crypto assets are then also marketed to customers in the same manner as traditional financial products which effectively means crypto assets are used and marketed as a substitute for traditional financial products.[125]

Within the South African regulatory framework, SARS has also adopted the uniform definition for cryptocurrency by adding the definition 'crypto assets' to tax law.[126] From a regulatory perspective, the South African Reserve Bank recognises that it does not regulate crypto assets[127] but it asserts its position that crypto assets are not fiat currency or legal tender in SA.[128] This position is consistent with that of most other jurisdictions.[129]

While SA does not currently have any domestic law or double tax agreement that specifically deals with income from crypto assets, transactions related to crypto asserts are subject to normal income tax rules and thus can be taxed on revenue account under 'gross income' or be treated under capital gains.

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[124] Financial Sector Conduct Authority op cit note 9.
[125] Ibid.
[126] National Treasury of South Africa *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2020 (2021) at 50.
[127] Previously defined as 'virtual currencies' in the "Position Paper on Virtual Currencies" issued by the SARB in 2014.
[128] Intergovermental Fintech Working Group op cit note 93.
[129] OECD (2020) op cit note 6.

4.2. A SA view on DeFi

SARS has not to date addressed the income tax consequences of income earned on crypto-asset deposits in DeFi transactions. However, existing legislation would apply to DeFi transactions where a deposit triggers a change of ownership, the deposit and subsequent redemption of those crypto assets.[130] Additionally, in terms of taxing crypto asset transactions, SA is likely to follow other common law jurisdictions' approach and tax income on the earlier of receipt or accrual, while capital receipts would be taxed only on disposal.[131]

The classification of interest on crypto assets within SA and internationally was analysed in a 2022 article by Shaun Parsons.[132] The article considers the definition of interest and crypto assets within the SA context, looks at common law definitions from court cases, interest within a double tax agreement and that DeFi is a part of crypto assets and that in SA, Luno and Ovex offer crypto accounts that produce 'interest'. The article suggests that interest can arise within a certain framework that requires three minimum elements, being that 'interest arises as compensation for the provision of a loan principal; secondly, that a contractual right to repayment of that principal exists; and thirdly, that interest is remuneration for the provision of capital, expressed or expressible as the quantum of that debt-claim.'[133] While the return from staking met the first and third requirements of the three element framework, it would not be conclusive to say that the income from staking would be interest.[134]

Practitioners in SA have opined that income from 'staking' should not be classified as interest and individuals will not be allowed to use the annual interest exemption.[135] However, in their view, when a crypto asset is provided as collateral for a loan (which is typically the case with most DeFi lending arrangements) then it is not considered a disposal and the income should be treated as interest, against which the annual interest exemption can be used. This is further supported with the view that staked tokens do not represent a debt claim of the

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[130] Parsons S & Schoonwinkel H "An Analysis of the Income Tax Consequences of Decentralized Finance (DeFi) in a South African Context and Beyond" (2023) 8 Bull. Intl. Taxn. Available at: https://research-ibfd-org.ezproxy.uct.ac.za/#/doc?url=/collections/bit/html/bit_2023_08_za_1.html (Accessed 20 August 2024).
[131] Parsons S & West C "Chapter 33: Crypto Assets: Tax Law and Policy in South Africa" in G. Kofler et al *Crypto Assets: Tax Law and Policy* (2024, IBFD) Books IBFD. Available at: https://research-ibfd-org.ezproxy.uct.ac.za/#/doc?url=/document/cat_c33 (Accessed 20 August 2024).
[132] Parsons S "What's in a Name?: The Classification of "Interest" on Crypto-assets in South Africa and Beyond" (2022) 50 *Intertax* (Issue 6/7). Available at: https://doi.org/10.54648/TAXI2022054.
[133] Ibid at 507–508.
[134] Ibid at 510.
[135] Chong J & Moolman L "No Doge-Ing the Tax Bill on Cryptocurrency Transactions" (4 August 2021). Available at: https://www.webberwentzel.com/News/Pages/nodoge-ing-the-tax-bill-on-cryptocurrency-transactions.aspx (Accessed 30 November 2023).

taxpayer.[136] However, given the wide possibilities of DeFi transactions, the type of income from these transactions can change depending on the specific terms of the arrangement entered into. Accordingly, in some cases the income may be considered interest as section 24J the Act does not explicitly limit interest on monetary loans as described in section 3.2.1 above.[137]

If the income from staking activities cannot be classified as interest, the alternative is that staking activities could be considered a trade as the taxpayer has an active participation in the process of transaction validation on the blockchain which is consistent with the scope of the 'trade' definition.[138] In such case, taxpayers involved in staking activities would be seen as conducting a trade and result in being taxed under the definition of 'gross income'.[139]

4.3. Staking example

In SA, intermediaries such as Luno and Ovex offer holders a return on crypto-asset deposits. Luno refers to this as a savings account, however, has since December 2022 stopped offering the product as they '…have concluded that there is no longer a sufficiently significant or stable market to offer Savings Wallet services in a way that meets our rigorous standards.'[140] Ovex still offers their interest account that offers '…a return of up to 20 per cent per annum depending on the type and amount of crypto asset invested, similar to a traditional call investment account. Interest applied is simple interest only, without compounding.'[141]

The key terms and conditions of the Luno (also referred to as the intermediary) staking account are summarised below:[142]

1. Staking is a process that allows you to participate in the functioning of a blockchain protocol by supporting the network's validation process. In order to stake, the user is required to commit crypto assets to a blockchain 'validator' in exchange for a share of the newly minted tokens and/or transaction fees from that validator.
2. Even though Luno uses a third-party validator to provide the Staking Services, the user's staked cryptocurrencies are not transferred to a third party. Luno will continue

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[136] Parsons S *Taxing Crypto-Asset Transactions: Foundations for a Globally Coordinated Approach* vol. 66 (IBFD Doctoral Series, IBFD 2022).
[137] Parsons S (2022) op cit note 132 at 505.
[138] Parsons S & West C op cit note 131.
[139] Ibid.
[140] Discover Luno, An Update on Luno's Savings Wallet (2023). Available at: https://discover.luno.com/an-update-on-lunos-savings-wallet/ (Accessed 12 May 2023).
[141] Interest Account, Ovex.io. Available at: https://storage.googleapis.com/ovex-static-assets/OVEX_Interest_Account_Terms_of_Service.pdf (Accessed 12 May 2023).
[142] Luno (2023). Available at: https://www.luno.com/legal/luno-staking-terms (Accessed 12 May 2023).

holding these crypto assets on behalf of the user and remains the beneficial owner of the cryptocurrencies.

3. If the third-party provider successfully validates using your staked crypto asset, a reward may be granted by the network. Rewards are determined by the protocols. The user acknowledges and agrees that the exact quantum of their staking reward, and hence any payouts, will be determined by the protocols of the applicable network, the third-party validator or Luno, to the amount staked.
4. Rewards will be credited to the user's wallet by taking into account the amount of the principal and previously accrued payouts that remain staked with Luno. Luno will credit the user's staking wallet with any earned rewards after receipt by Luno, less applicable fees.
5. The user is able to unstake all or a portion of the staked crypto asset at any time. In some cases, withdrawal of staked assets may be delayed as a result of protocol unstaking periods or network conditions.

The above terms and conditions indicate that the user remains the owner of the crypto assets and is able to withdraw at any time. Furthermore, the staking rewards are received in line with the protocol which recognises that a user has committed crypto assets to the network and accordingly should be rewarded for doing this. The Luno staking account is an example of indirect staking as the user merely deposits their capital and the intermediary performs the actual staking activity on behalf of the user.

Under part (a) of the interest definition in section 24J, the staking services offered by the intermediary needs to be in respect of financial arrangement. The general meaning of financial arrangement is a contractual arrangement of finance or credit. The Luno staking service is provided by Luno as the intermediary and the network protocol. The network protocol is executed by way of a smart contract that lays out the contractual terms and conditions the user agrees to. As part of the protocol, the user will receive a reward for committing their crypto assets to the network. Accordingly, by engaging with an intermediary staking service, the user agrees to the terms and conditions of the network protocol which establishes an arrangement.

It is not clear if this would be considered a financial arrangement, as the reference to 'financial' includes the term money and crypto assets are not considered as money.[143] However,

[143] Intergovermental Fintech Working Group op cit note 93.

it should be noted that the term ‘any crypto asset’ is defined as a financial instrument under section 1 of the Act which may suggest that a financial arrangement can also exist where a crypto asset is involved. Additionally, the term ‘crypto asset’ is used to describe digital financial assets based on distributed ledger technology and again may indicate that a financial arrangement can exist in terms of a crypto asset.[144]

Additionally, under part (a), the reward from staking crypto assets with Luno needs to be either ‘interest’ (its common law understanding) or a ‘similar finance charge’. The reward for staking crypto assets is acknowledged by the protocol as the user allocates and commits their crypto assets to the network and while they retain ownership, they are not able to transact with their crypto assets. This resembles the scenarios mentioned in case law that the user experiences deprivation of their crypto assets and the other party compensates the user for this deprivation. Thus, it will be likely that the user is receiving an amount which could be classified as interest from the Luno staking service. It is also suggested that the reward from the staking service offered by Luno is in substance and in nature akin to interest and thus if the amount cannot be considered to be interest, then it may be considered a ‘similar finance charge’.

In summary, while it seems likely that the return from staking crypto assets with Luno, meets the definition of interest under part (a) of section 24J it is still uncertain as to the existence of a ‘financial arrangement’. There seems to be sufficient evidence that the return will fit into the ‘interest or similar finance charge’ requirement as established by the common law understanding of interest.

Moving onto part (b) of the interest definition in section 24J, the requirement is that the lender be entitled to an amount payable by the borrower to the lender in terms of a lending arrangement. Here the lending arrangement requires that the borrower (the network protocol via the intermediary) return the same instrument to the lender. Accordingly, the user (as the lender) provides the network protocol (the borrower) with a crypto asset and in return will reward the user with the same crypto assets. Staking with Luno (indirect staking) could recognise that there is (1) a loan principal (the amount which is staked and is also used to determine the staking reward), and (2) the right of repayment arises mainly from the intermediary who conducts the staking on behalf of the user and has to return the capital to the user. Additionally, the right to repayment is also determined by the protocol which essentially requires the user to commit their crypto assets to the network so that it may be used for

[144] Ibid.

validation and that it can be returned to the user upon instruction. The Luno terms and conditions indicate that the user may withdraw and that the user remains in ownership of the crypto assets and that Luno acts on behalf of the user. While all of this is at intermediary level, one could look to the level of the PoS protocol that essentially drives the staking activity. The fact that the protocol allows users to withdraw seems to indicate that the protocol acknowledges that the funds are to be returned to the user who has committed the crypto asset to the network and hence the second requirement can be satisfied. This indicates that the borrower does in fact return the instrument to the lender; however, it should be noted that this is not conclusive as the ownership of the crypto asset does not transfer and the user remains the beneficial owner at all times through the staking process.

In summary of part (b), the Luno staking service seems to present the attributes of a lending arrangement (largely based on the obligation for Luno to repay the user their crypto asset once they elect to withdraw); however, the term lending arrangement states that the borrower must return the same kind of instrument to the lender. It is not clear whether this can occur if the user never gives up ownership of the crypto asset although indirect staking seems more indicative as there is an intermediary involved rather than direct staking where the user undoubtedly retains ownership of the crypto asset. In closing, a user earning income from conducting indirect staking via an intermediary, such as Luno, would more likely meet the definition in part (a) or (b) of the interest definition than compared to direct staking where no intermediary is involved.

4.4. Application of WTI

The detailed analysis of WTI within SA done in chapter 3 already outlines the requirements for WTI to apply within SA tax law. This section will determine if the income from staking crypto assets could be sufficient to trigger WTI provisions of the Act.

In terms of the Act, a non-resident is taxed in SA where '….any interest that is paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received or accrued from a source within the Republic in terms of section 9(2)(*b*).'

The staking example above has already indicated that it might be possible for the income from staking crypto assets with an intermediary such as Luno to be defined as interest under part (a) or part (b) in section 24J.

In terms of part (a), there is some stability found in the common law understanding of interest and similar finance charges when compared to the income from staking crypto assets.

However, the uncertainty arises with an intermediary staking service meeting the definition of a ‘financial arrangement’ as this term is not defined. There seems to be indication that if the term financial instrument is used, the activity of crypto asset staking would create a contractual obligation that involves credit and a crypto asset. Thus, it will be considered that such contractual obligation can give rise to an amount that is may be classified as interest.

Under part (b) of the interest definition, it is not clear whether the lending arrangement requirement is fulfilled, as this requires the borrower to return the instrument to the lender. When considering the use of intermediary staking services (indirect staking), the user as the lender remains the beneficial owner of the crypto asset and thus it is challenging to see how the borrower can return the crypto asset to the lender. However, under indirect staking the intermediary is obligated to repay the crypto asset once the user requests withdrawal and this seems to indicate that there is a possibility that such repayment can be considered a return of the instrument, however this is not conclusive. With direct staking there is no intermediary involved and thus no repayment to the user.

In terms of the words ‘paid by’ as discussed in section 3.3, practically, a crypto exchange is likely the last person facing the non-resident and would also be the appropriate person to withhold the tax on interest from payments to non-residents. Furthermore, crypto assets are not considered to be currency, however the ‘paid’ requirement can occur in cash or other than cash. Thus, it is likely that the reward for staking crypto assets with an intermediary will meet the requirement of the amount being ‘paid’.

The source requirement deems interest to be from a SA source for the non-resident where any funds or credit are utilised or applied in SA by any person in terms of any form of interest-bearing arrangement. This requirement is excluded as part of this research and thus will be assumed that that the intermediary applies or utilises the crypto assets in SA, it would be from a SA source, unless a tax treaty can override the source.

Accordingly, if the above is considered, the return from indirect staking is likely to be defined as interest and could trigger the WTI provisions if a non-resident participated in the Luno staking activity and the interest is paid to the non-resident. However, where a non-resident participates in a direct staking activity and applies the funds or credit in SA, it is unlikely that the WTI provisions would be triggered and thus the income should be taxed as normal income.

By the end of Chapter 5, the study will determine if section 50E(3) of the Act can apply which allows the rate at which the WTI applies (15 per cent) to be reduced or eliminated in terms of a double tax treaty.

5. DEFINITION OF INTEREST UNDER THE OECD MODEL

Chapter 5 will review the interpretation of terms defined in a tax treaty based on the OECD Model and the application of Article 11 to the income from staking activities. This chapter will seek to determine if income from staking activities find application under Article 11 of the OECD Model and thus reduces the WTI rate in the conclusion of chapter 4.

5.1. Introduction

This section will explore the definition of interest under Article 11 of the OECD Model. Then it will explore if the return from crypto assets (and application of staking activities) can be taxed as interest under the OECD Model by contrasting similarities to traditional financial products such as savings deposits. This is done to further support how the interpretation and application of interest from crypto assets should be considered.

The sources will mostly be from the OECD Model, its commentary, international case law and other international sources. While the OECD Model does not expressly deal with crypto assets, the research will firstly seek to determine if the return from staking activities can be taxed as interest under Article 11 but may then explore other articles under which it may be taxed.

The purpose of a tax treaty is to prevent and avoid double tax but not necessarily to eliminate it. This is in line with section 108 of the Act and was confirmed in the *Tradehold* case at paragraph 15 '….Its principal objectives are the avoidance of double taxation and the prevention of fiscal evasion'.[145]

5.1.1. Interpretation

Article 2 of the Vienna Convention on the Law of Treaties ("VCLT") provides that a treaty is an international agreement which is concluded between States and is governed by international law.[146] Under international tax law, tax treaties must be interpreted in accordance with articles 31 and 32 of the VCLT which requires interpretation to be done 'in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of their object and purpose'.[147] While SA is not a signatory of the Vienna Convention, section

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[145] *Commissioner for the South African Revenue Service v Tradehold Limited* (132/11) (2012) ZASCA 61.
[146] *Vienna Convention on the Law of Treaties* (23 May 1969) United Nations Treaty Series vol. 1155, at 331.
[147] Ibid.

233 of the Constitution, 1996, requires a court to prefer a reasonable interpretation of legislation that is consistent with international law.[148]

Where the tax treaty is based on the OECD Model, certain terms will be defined. However, if the term is not defined in the tax treaty, then the term needs to be considered under the law of the state as per Article 3(2) of the OECD Model. Additionally, when countries such as SA negotiate tax treaties, they would be well aware if there are no definitions for certain terms and thus, they expect it to have an international tax meaning.[149]

In addition, when interpretation is required, the ambulatory approach can be followed and the correct approach to interpretation is reflected by the Supreme Court in *Fowler v HRMC* at paragraph 18, stating that 'The OECD Commentaries are updated from time to time, so that they may (and do in the present case) post-date a particular double taxation treaty. Nonetheless they are to be given such persuasive force as aids to interpretation as the cogency of their reasoning deserve'.[150]

Thus, the use of the 2017 OECD Model will be leaning towards the dynamic interpretation of the purpose and context which is in line with the VCLT. Furthermore, this follows the interpretation that considers technological advances and is a 'doctrine of updating construction' while interpreting an 'ongoing Act' (always speaking).[151]

Commentators note that domestic law is only considered for interpretation purposes when nothing more can be derived from the treaty itself.[152] Additionally, Article 32 of the VCLT allows 'supplementary means of interpretation', such as 'the preparatory work of the treaty' or 'the circumstances of its conclusion' to be taken into account. Accordingly, if tax treaty negotiations are based on the OECD Model, then the OECD commentary may provide guidance in establishing the meaning of treaty provisions as they qualify as supplementary means of interpretation under Article 32 of the VCLT. Thus, it reasonable to assume that the contracting states intended terms to have the meaning they have in the OECD Model, as outlined in the OECD Commentary.[153]

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[148] Wallis M "Interpretation Before and After Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 4 SA 593 (SCA)" (2019) PER / PELJ (22). Available at: http://dx.doi.org/10.17159/1727-3781/2019/v22i0a7416 (Accessed 12 March 2023).
[149] *International Tax: A South African Perspective* 5 ed (2019) at 544.
[150] *Fowler v HRMC* [2020] UKSC 22 at para 18.
[151] Bennion F *Statutory Interpretation* 5th ed. (2020) section 288 at 889-890.
[152] Lang M *Introduction to the Law of Double Taxation Conventions* 2nd ed. (2013), at par.74, p 45.
[153] Lang M & Brugger F "The role of the OECD Commentary in tax treaty interpretation" (2008) Austl. Tax F. 23, p 95.

5.2. Interest and Article 11 of the OECD Model

The function of Article 11 of the OECD Model is to allocate taxing rights for interest paid from a source state to a resident state. While Article 11 gives the resident state a taxing right, it is not exclusive as the source state may also have a taxing right and thus be taxed according to the laws of that state but limited to 10 per cent on the gross amount of interest. The OECD Model considers that an autonomous definition of interest provides greater legal certainty than if referred to the domestic meaning.[154] Accordingly, the term 'interest' is defined in Article 11(3) to mean income from debt claims of every kind. In terms of source, Article 11(5) includes a source rule which deems interest to arise in a contracting state when the payer is a resident of that state. These are the main elements to consider in Article 11 for purposes of this study.

It should be noted that the remainder of Article 11 of the OECD Model provides two exceptions from the main allocation rule. The first is Article 11(4) that solves a possible conflict issue with Article 7 dealing with business profits when interest payments are made to a permanent establishment in the source state. The second is Article 11(6) that restricts the taxing right to interest that does not exceed an arm's length amount. For purposes of this study these are not considered as relevant to the analysis.

5.2.1. History

The OEEC[155] working paper in 1959 established the first version of the interest definition which at that time determined interest to be income from indebtedness or debt-claims of every kind, notes of indebtedness, deposits, cash guarantees and other capital assets which can be assimilated to debt-claims or loans.[156] By 1960, the third report had drafted the definition to be income from 'debt-claims of every kind, as well as all other income assimilated by the taxation law to income from money lent'.[157] By the time of first OECD draft report in 1963, the definition had maintained the reference to domestic law that specified the state where the interest arises must be considered.

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[154] OECD (2019), Paragraph 21 of the Article 11 Commentary.

[155] The Organisation for European Economic Co-operation which included delegates from the Netherlands, Switzerland and Germany.

[156] OEEC Working Party No. 11 of the Fiscal Committee (France and Belgium) – Report on the Taxation of Interest, Paris, doc. FC/WP11(59)1 (15 Jan. 1959), available at http://taxtreatieshistory.org/data/html/FC-WP11(59)1E.html (accessed 20 March 2024), at p 1-2.

[157] OEEC Working Party No. 11 of the Fiscal Committee (France and Belgium) – Third Report on the Taxation of Interest, Paris, doc. FC/WP11(60)2 (20 Oct. 1960), available at http://taxtreatieshistory.org/data/html/FC-WP11(60)2E.html (accessed 20 March 2024), at p 3.

Importantly, a departure from referring to the domestic law came at the time of the 1977 OECD Model which removed the reference to domestic law from the definition of interest. This change was in line with a general approach of avoiding references to domestic law as far as possible, a procedure considered to be better from the perspective of legal certainty.[158]

However, many tax treaties still wish to achieve the autonomous definition as envisaged by the OECD Model but in addition prefer to use the reference 'assimilated to income from money lent' which allows the definition to be considered under domestic taxation law. As of 2013, there are more than 600 tax treaties in force which still include the 1963 OECD Draft language or some similar wording.[159]

Nevertheless, the definition of interest under Article 11(3) has remained unchanged since the 1977 OECD Model and reads as follows:

> *'The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.'*

However, the OECD Commentary added paragraph 21.1 in 1995 dealing with non-traditional financial instruments such as interest rate swaps. In essence this paragraph describes that the definition of interest will not normally apply to payments outside of the traditional financial instruments if there is no underlying debt component. However, when faced with a non-traditional financial instrument payment, the definition of interest should be applied "to the extent that a loan is considered to exist under a 'substance over form' rule, an 'abuse of rights' principle, or any similar doctrine." [160]

Based on the above, there seems to be an indication that as further developments in finance and technology occur, so too should the laws and interpretation thereof be considered in a wide context. Considering that the OECD Commentary has not specifically mentioned or addressed crypto assets, one may consider a scenario where there is a loan or a debt-claim in the form of a crypto asset (which in this case may be seen as non-traditional finance) then the definition of interest should apply by at least using the substance over form principle.

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[158] OECD (2019), Paragraph 19 of the Article 11 Commentary.
[159] Haslehner W, in Reimer & Rust (ed.), *Klaus Vogel on Double Taxation Conventions*, 5th ed. (2021), Article 11 at no. 105.
[160] OECD (2019), Paragraph 21.1 of the Article 11 Commentary.

From the above, the current OECD Model does not reference domestic law, however, many tax treaties still refer to domestic law in the interest definition. Thus, it would be important to look at the source state domestic law when considering tax treaties.

Interestingly, the OECD Model does not use the word 'money' but rather 'debt-claims' which indicates that the form of capital should also be given a wide understanding and that it is not only money that can generate interest in its traditional sense. However, careful consideration must be given to the fact that many tax treaties may contain the 1963 OECD wording which refers back to domestic law and uses the word 'money' which potentially restricts the application of Article 11 in the context of crypto assets.

5.2.2. The 'paid requirement'

Article 11(1) of the OECD Model requires that interest arise in a state and be paid to a resident of the other state. Importantly, the word 'paid' is required for Article 11 to apply and thus is an important requirement to determine the tax treatment.

According to the OECD Commentary on Article 11, the term 'paid' has a very broad meaning, covering any 'fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom'.[161] Furthermore, while a formal contract is not necessarily required, the creditor must at least agree to the compensation which can be settled in various ways such as performance in kind or even by way of set off.[162]

The importance of the interest being paid is further highlighted when considering that Article 11(4) contains the term 'beneficial owner' and thus by definition the beneficial owner has the right to dispose of the interest if it has been 'paid' to him.[163] Lastly, the 'paid' requirement is supported by reading Article 11(1) together with Article 11(5) as the latter uses the words 'payer', 'the person paying the interest' and 'the indebtedness on which the interest is paid'. As a result, interest can only arise in a state when it has been paid.

When considering payment in terms of crypto assets and more specifically when conducting staking activities, the relevant protocols determines that the user is rewarded with additional crypto asset tokens and is usually the same as the crypto asset they initially staked

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[161] OECD (2019), Paragraph 5 of the Article 11 Commentary.

[162] Vogel K *Klaus Vogel on Double Taxation Conventions* (3rd ed., Kluwer 1997) p 714; and Haslehner W, "Article 11: Interest" in *Klaus Vogel on Double Taxation Conventions* (4th ed., Reimer & Rust eds., Kluwer 2015) p 904.

[163] Haslehner W in Reimer & Rust (eds) *Klaus Vogel on Double Taxation Conventions* 5th ed. (2021) Article 11 at 49.

with.[164] In the case of indirect staking such as the Luno staking service, the intermediary will pay the user and the rewards are determined by the network protocols.[165] While with direct staking, the payment will occur directly from the relevant network protocol to the user. Thus, it would be evident that a payment is made from the protocol to the user or staker with an intermediary and accordingly the 'paid' requirement will be met.

5.2.3. Article 11(3) - Definition of interest

Article 11(3) of the OECD Model provides the definition of interest mainly as income from debt-claims of every kind and further provides some examples to illustrate that it is not exhaustive. While the term 'debt-claim' is not defined in the OECD Model, the wording of Article 11(3) gives it a broad meaning.[166]

Accordingly, the definition includes cash deposits and security in the form of money, as well as government securities and bonds and debentures.[167] It would not matter the type of payment or when the payment happens, rather the focus would be on the understanding that a return of more than the amount of capital will be interest.[168] However, once the debt claim has been established it is important that the interest be derived from the debt claim as the provision of the use of capital as it is not sufficient for the interest payment to just be connected to the debt claim.[169]

There are various views of what can be considered as interest, such as the OECD Commentary that mentions interest is generally understood to mean remuneration on money lent.[170] Additionally, interest can also be seen as the payment for a transfer of the use of debt capital, or the remuneration received for making capital available.[171] The intention of the interest definition aims to include income that is paid by the borrower to the lender for the surrender of money or, said differently, remuneration is granted as consideration for the surrender of money.[172] Considering the above and applying an autonomous interpretation to

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[164] Banerjee op cit note 68.
[165] Luno op cit note 142.
[166] Vogel op cit note 162 at p 732 notes that the term "debt-claim" should be understood in its broadest sense.
[167] OECD (2019), Paragraph 18 of the Article 11 Commentary.
[168] Helminen M "Article 11: Interest – Global Tax Treaty Commentaries" (Accessed 10 December 2023) at s 5.1.1.3.1.
[169] Haslehner op cit note 163, Art 11 at 90.
[170] OECD (2019), Paragraph 1 of the Article 11 Commentary.
[171] Vogel op cit note 162 at p 731.
[172] Pöllath R & Lohbeck A in Vogel K & Lehner M (eds) *Doppelbesteuerungsabkommen* 5th ed. (Beck 2008), Art 11, p 56 and 59a.

the term 'income' will result that all payments for the surrender of money will be income from a debt-claim and be defined as interest under Article 11(3) of the OECD Model.[173]

Furthermore, the definition should be approached with a broad understanding that covers all payments made for the use of capital.[174] It should be noted that while the broad meaning should be applied, the debt claim still needs to have a legal basis, meaning that it must be valid and enforceable. Accordingly, if there is legal basis, neither the origin of the claim nor the purpose for which the debt was incurred would be relevant.[175]

In order to further understand the term 'debt-claim', the OECD Commentary also addresses the situation specific to interest paid when connected to a permanent establishment. Here consideration is given to the principles developed in the OECD's report entitled Attribution of Profits to Permanent Establishments.[176] The concept of 'economic' ownership is referred to in context of Article 7 (2) of the OECD Model and means the equivalent of ownership for income tax purposes together with the benefits and burdens of the debt claim.[177] Accordingly, if there is no debt-claim then there is no interest to tax under Article 11 of the OECD Model. Taking the above into account and referring to the current OECD Model wording, it is possible to consider that a debt-claim in the form of crypto assets and that has legal premise for repayment should be a valid debt-claim.

When analysing the definition of interest under the SA context, it was suggested that the income from indirect staking activities is likely to be considered interest. However, under the international application and the OECD Model, the definition should be expanded to now include the element of a debt-claim as per the OECD Model definition.

When considering indirect staking activities, it can be said that the user is required to depart with his capital in the form of a crypto asset (the user will use fiat currency to acquire the crypto asset) and typically deposit the crypto assets with an intermediary. The intermediary now uses this crypto asset to conduct staking activities on behalf of the user. As per the relevant network protocol, the user will be rewarded with crypto assets in addition to or over and above the original principal amount. From the above analysis, the user would be considered to have surrendered their crypto asset (for the intermediary to perform staking activities) and in return

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[173] Wassermeyer F *Doppelbesteuerung* (F Wassermeyer, M Lang & J Schuch eds., 2nd ed, Linde 2010) Art. 11, p 72.
[174] Haslehner op cit note 163, Art 11 at 7.
[175] Haslehner op cit note 163, Article 11 at 89.
[176] OECD *Attribution of Profits to Permanent Establishments* (Paris, 2010).
[177] OECD (2019), Paragraph 25.1 of the Article 11 Commentary.

can be said to receive remuneration for the use of the crypto asset when the protocol provides the user with the crypto asset rewards.

Accordingly, a user that conducts indirect staking activities, surrenders their crypto asset and receives remuneration for the use of their crypto asset that will meet the definition of interest under Article 11(3) of the OECD Model. It should be noted that tax treaties may vary from the OECD Model and thus the relevant tax treaty needs to be considered as it may likely refer back to domestic legislation to define the term 'interest'. Thus, when attempting to categorise income from indirect staking crypto assets the domestic legislation is important as the definition of interest and dividends may overlap as some countries have taken different approaches to the OECD Model. In Germany, for example, one-quarter of German tax treaties include a tie-breaker rule in their definitions of interest which explicitly places the definition of dividends over the definition of interest.[178] In contrast, Australia unilaterally rules that the definition of interest is predominant over the definition of dividends for tax treaty purposes.[179]

5.2.4. Non-Traditional Financial Instruments

As mentioned above, the OECD Commentary provides examples of the commonly known and traditional financial scenarios that would typically create interest, such as cash deposits. In contrast, the definition of interest under Article 11 of the OECD Model does not normally apply to payments made under certain kinds of non-traditional financial instruments where there is no underlying debt.

However, in 2009 the United Nations included specific commentary on non-traditional financial arrangements under Islamic law, which prohibits the payment of 'interest', and stated that such instruments will be regarded as equivalent to loans where this reflects the economic reality of the instrument, even if its legal form does not correspond to a loan.[180] Considering the OECD Commentary, it should be noted that the interest definition will still apply to the extent that a loan is considered to exist under a 'substance over form' rule, an 'abuse of rights' principle, or any similar doctrine.[181]

Interestingly, the OECD Commentary highlights a situation of interest coupons and recognises that it is possible that the owner of the interest coupons still has a valid debt-claim

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[178] German tax treaties e.g. with Canada 2001 (Art. 11 Para. 4), Italy 1989 (Art. 11 Para. 4), Mexico 2008 (Art. 11 Para. 4), the Republic of Korea 2000 (Art. 11 Para. 5) and Luxembourg 2012 (Art. 11 Para. 2).
[179] Sec. 3 Para. 2A of the Australian International Tax Agreement Act 1953.
[180] Haslehner op cit note 163, Article 11 at 111; Plambeck et al., *'General Report'*, at 653 et seq.; in general, OECD, *Taxation of New Financial Instruments*, (1994).
[181] Vogel op cit note 162 at 730.

even though they did not lend the capital, but they have ownership of the interest coupon and thus still have the legal right to the interest payments. Accordingly, such payments to settle the debt-claim will meet the definition of interest under Article 11(3) of the OECD Model.[182] However, when considering financial derivatives such as options, forwards and interest rate swaps, these agreements do not require an initial investment nor is there reference to payments to be made as they are very conditional in nature. Accordingly, since there is no initial investment, there has been no provision of capital for which the payment is made and therefore these payments cannot be defined as interest.[183] Thus, even when dealing with the non-traditional finance arrangements, the requirement is that there must be a legal and valid debt-claim but in order for there to be a debt-claim there must be a surrender of capital or alternatively there must be a provision for the use of capital. If these are present it will be sufficient to meet the definition of interest.

When drawing similarities between the banks in traditional finance and indirect staking of crypto assets, banking has an accepted practice to use a set of guidelines or directives that outline the objectives, strategies, and limitations for managing an investment portfolio. Similarly, this is commonly found in the structure of indirect staking given that the intermediary effectively assumes the obligation to manage the staker/delegator's crypto asset and locks them within a certain blockchain network running a validator node to earn rewards from staking.[184]

When considering the type of income that staking crypto assets can fall into, capital income is the income generated from investments in assets or financial instruments, including interest earned from holding deposits, dividends from shareholders, and capital gains from selling assets at a higher price. It is typically associated with passive activities, as it relies on the performance of investments or assets rather than actively managing or operating a business.[185]

Based on this, where a user engages in passive investment activity and earns income from indirect staking, the resulting income may be classified as interest income. This is based on the contractual relationship between the staker and the intermediary assuming the form of an

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[182] Vogel op cit note 162 at 723.
[183] Haslehner op cit note 163, Art 11 at 102.
[184] Cipollini C "Article: Crypto Staking Taxation Across Selected Countries: A Critical Evaluation" (2024) 52 *Intertax* 2 p 133.
[185] Harding M *Taxation of Dividend, Interest, and Capital Gain Income* (OECD 2013). Available at: https://www.oecd-ilibrary.org/docserver/5k3wh96w246k-en.pdf?expires=1692436387&=id&accname=guest&checksum=2E63170DB51ABDCCAC8ECE500A000E42 (Accessed 10 June 2024).

investment mandate assisted by a complementary deposit agreement and thus is similar to earning income from holding deposits in savings accounts.[186]

5.3. Conclusion

The term 'interest' is defined in Article 11(3) of the OECD Model to mean income from debt claims of every kind. In order for there to be a debt-claim, there must be legal basis for the claim or at least have the understanding that under a 'substance over form' rule that the lender has surrendered their capital to the borrower. The guidance from the OECD Model within non-traditional situations mentioned can also be considered. This is summarised as even if there is no actual loan, but the economic reality is that of a loan, then it should be treated as such. Similarly, while it may be difficult to determine in some circumstances if a loan by way of indirect staking a crypto asset is made, the economic reality is that the capital will be returned to the user and rewards will be given to the user for the use of the capital and thus should be considered a loan.

Given the OECD Model does not use the word 'money' but rather 'debt-claims' when defining interest, the appropriate interpretation suggests that a wide view can be taken that not only money can generate interest and that crypto assets can also generate interest as defined. However, careful consideration must be given to the fact that many tax treaties may contain the 1963 OECD wording which refers back to domestic law and uses the word 'money'. This wording may restrict the application of Article 11, potentially excluding income from crypto assets.

The OECD Model definition of interest requires that the amount be 'paid' and this takes a wide meaning. In the case of indirect staking such as the Luno staking service, the intermediary will pay the user and the rewards are determined by the network protocols which meets the payment requirement under the interest definition of Article 11 the OECD Model.

When applying the definition of interest under Article 11 of the OECD Model to crypto assets and indirect staking activities, the understanding is that the user stakes their own capital which is available for someone else to use. While the Luno terms and conditions still indicate that the user retains ownership of the capital, the funds are 'locked' away and used by Luno's third party staking provider who uses the funds to conduct staking services and this amounts to a surrender of capital or the use of capital. In exchange for this, the network protocol will give the staker rewards in the form of crypto assets. The legal obligation exists when the staker

[186] Cipollini op cit note 184 at 137.

agrees to the network protocol that will determine how much and when the rewards are provided. Accordingly, a legal obligation is present for the third-party staking provider to reward the staker in line with the network protocol (which creates the debt-claim) and therefore, the additional crypto assets received (over and above the capital) can be seen as interest under Article 11(3) of the OECD Model.

Based on the above analysis, when a user stakes crypto assets with an intermediary to perform indirect staking activity, there will be a surrender of crypto assets to the intermediary. This is then confirmed as a debt-claim when the network protocol recognises that it is using the user's crypto assets and determines it will reward the user for the use of their crypto assets. Thus, the user has a valid debt-claim and the income from this debt-claim is likely to be classified as interest and the benefits of Article 11 of the OECD Model may apply.

6. THE EXEMPLAR

Following the analysis in chapter 4 dealing with the application of the WTI provisions and the analysis in chapter 5 dealing with the OECD Model approach to interest and staking activities, this section will demonstrate the application of the above analysis by way of an exemplar whereby a hypothetical individual who is a tax resident of the UK invests money in SA via an intermediary such as Luno and participates in indirect staking services. From this, it will be determined if the return of staking activities with an intermediary will trigger the WTI provisions and subsequently, if the SA-UK tax treaty[187] has the ability to reduce this withholding tax.

In SA case law, the courts will tend to rely on jurisdictions that are similar to SA and thus it is common that the UK provides frequent sources of interpretative guidance in SA.[188] In terms of treaty law, most of the tax treaties in dispute are based on the OECD Model and references to foreign law are "quite common", thus the UK is an appropriate jurisdiction to consider.[189]

It should be noted that this is not a case study which would analyse the topic of interest applying to income from staking crypto assets from multiple perspectives (in this case both SA and UK domestic law would have to be analysed). This section only aims to illustrate, from a SA perspective, the application of what has been analysed in this study to a specific example.

6.1. Facts

The hypothetical scenario considers that a UK individual, who is a UK tax resident, decides to participate in crypto staking activities offered by the service provider in SA called Luno.

As mentioned in section 4.3 above, Luno provides a staking account, which can be summarised as an indirect staking activity. The blockchain protocol will determine the rewards given to the staker (i.e. the UK individual) based on the amount of crypto assets staked. The analysis also highlighted that the UK individual would remain the beneficial owner of the crypto assets. The source of the income will be assumed to be in SA as Luno offers this service in SA.

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[187] SA-UK tax treaty op cit note 32.
[188] Carvalho R, Daniels I & Dewar M et al "Is there evidence of increasing harmonization in the interpretation of tax treaties by courts in their reference to foreign court decisions? A study of South African case law" (2017) 10(71) Bulletin for International Taxation at 1.2-1.4.
[189] In *re Taute* (1830) 1 Menzies 497 as noted by PJ Hattingh in "An Overview of the Court System of South Africa with Emphasis on the Resolution of Tax Disputes" (2011) 65 Bull. Intl. Taxn. 3, sec. 1.2. and sec. 1.5.

6.2. The UK approach on staking crypto assets

The HRMC notes that in terms of UK tax law, there is no statutory definition of interest and that there must be a sum of money advanced or debt incurred in order for interest to exist. Additionally, interest can only arise by virtue of a legal right. Given the lack of a statutory definition, UK case law can help determine what constitutes interest, and the best-known quotation on interest comes from Rowlatt J in *Bennett v Ogston* (1930) 15 TC 374 who described interest as ‘payment by time for the use of money’.[190]

In the guidance issued by the HRMC in the UK, ‘DeFi’ transactions (which includes crypto staking) are taxed depending on their nature, being either capital or income. The former is subject to tax on capital gains while the latter is subject to income tax.[191] As an example, the HRMC states that a return which has been agreed upon, for example 5 per cent per annum, would indicate a revenue receipt. However, where the return is unknown and speculative, it would be indicative of a capital receipt.[192]

Regarding crypto staking, the HRMC guidance states that the return from staking can be compared to interest received by a lender in exchange for the service of lending money (despite the fact that the return paid for the service of lending tokens is not considered interest for tax purposes). As an example, the HRMC specifies that a borrower may agree to pay the lender 5 per cent of the principle per year for the duration of the arrangement. This is considered a service return. The HRMC then provides an analogy to suggest that the return obtained by the lender/liquidity provider could be viewed as remuneration for the use of the tokens.[193]

As a result, the HRMC expects the return to be similar to interest but emphasises that this similarity ignores the fact that it is not paid in monetary or currency terms. In conclusion, the HRMC accepts that, in general, where it can be demonstrated that the return is paid to compensate the lender/liquidity provider for the provision of a service of lending/staking tokens, the return received by the lender/liquidity provider will have the same nature as interest and thus be considered an income (revenue) receipt.[194] On the other hand, countries such as

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[190] HM Revenue & Customs *Corporate Finance Manual* (2024). Available at: https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm33030 (Accessed 10 June 2024).
[191] HM Revenue & Customs *Cryptoassets Manual* (2021). Available at: https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto61212 (accessed 10 June 2024).
[192] HM Revenue & Customs *Cryptoassets Manual* (2021). Available at: https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto61214 (accessed 10 June 2024).
[193] Ibid.
[194] Ibid.

Spain[195] and Sweden[196] seem to indicate that the income from staking activities can be linked to investment type income and can be taxed at a savings rate or capital rate[197] both of which are typically more lenient that income tax rates.

Article 11 of the OECD Model does not refer to the word 'money' but rather 'debt-claims' which indicates that the form of capital should also be given a wide understanding and that it is not only money that can generate interest in a strict sense. This is in contrast to the UK where the HRMC has stated that while there is no definition for tax purposes, case law provides that interest is the return received for the use of a sum of 'money' belonging to another. Crucially, the HRMC does not consider crypto assets to be currency or money, therefore the rate of return is not considered to be interest.[198]

Based on the above, the HRMC is largely aligned with the definition of interest under Article 11 of the OECD Model as both consider interest to arise when there is payment for the use of money. The HRMC has even accepted that returns from staking and interest are similar in nature. However, the OECD Model takes a much wider view and does not restrict the definition to the use of money whereas the HRMC explicitly states that interest can only be a return on money and crypto assets are not defined as money. This suggests that the OECD Model may be able to take the view that interest can arise from crypto asset (if it is a debt claim) but also highlights that the OECD Model is merely a base from which countries negotiate tax treaties and that domestic law might provide more guidance regarding the interpretation of the respective tax treaties.

6.3. SA withholding tax

The SA WTI provisions have been analysed in section 4.4 above and have indicated that in terms of the interest definition under section 24J of the Act and the WTI provisions, the return from participating in indirect staking activities with Luno might reasonably be considered as interest and thus trigger the WTI provisions. In terms of the SA approach, it may be likely that

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[195] Agencia Tributaria *Manual práctico de Renta 2022. Compra y venta de monedas virtuales: tributación en el IRPF del inversor* (2022). Available at: https://sede.agenciatributaria.gob.es/Sede/ ayuda/manuales-videos-folletos/manuales-practicos/irpf-2022/c11-ganancias-perdidas-patrimoniales/monedas-virtuales/compra-venta-monedas-virtuales-tributacion-inversor. html (Accessed 15 June 2024).
[196] Swedish Income Tax Act, Chap 42, s. 1.
[197] Skatteverket, *Kryptovalutor* (2023), https://skatteverket.se/privat/skatter/vardepapper/andratillgangar/kryptovalutor.4.15532c7b1442f256bae11b60.html?q=staking (accessed 10 Oct. 2023); Tiwari P, *A Comprehensive Guide on Swedish Crypto Taxes 2023* (Kryptoskatt 2023), https://kryptoskatt.com/guides/a-comprehensive-guide-on-swedish-cryptotaxes-2023 (Accessed 10 March 2024).
[198] HM Revenue & Customs *Cryptoassets Manual* (2021). Available at: https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto61110 (Accessed 10 June 2024).

a SA court would allow for the WTI provisions to apply to the income from indirect staking crypto assets.

The same applies in this exemplar as the UK tax resident should be taxed in SA as interest (the return from staking activities with Luno) is paid to a non-resident and the source is from SA. Accordingly, the 15 per cent WTI would apply to the interest payment from Luno to the UK individual. However, section 50E(3) of the Act may reduce this amount in accordance with the SA-UK tax treaty.

6.4. The SA-UK Tax Treaty

Article 11 of the OECD Model has been analysed in section 5.2 above and notes that the OECD Model does not contain a definition of 'crypto assets'. Furthermore, the OECD Model gives a wide view to interest in that it can arise from any debt-claim and not just from money. In terms of the OECD Model, Article 11 can give both the residence and source state taxing rights, typically applying limits to source taxing rights.

Interestingly, while largely based on the OECD Model, Article 11 (1) of the SA-UK tax treaty does not give the source state taxing rights and thus the residence state has an exclusive right to tax the interest under Article 11 if the resident is the beneficial owner of the interest. Furthermore, while the definition of interest is the same as Article 11 of the OECD Model, the definition is narrowed down by giving priority to dividends under Article 10, stating that interest shall not include any item treated as a dividend under Article 10.

Applying the income from indirect staking of crypto assets to Article 11 of the SA-UK tax treaty will reasonably meet the definition of interest as discussed in section 5.3 above. However, the SA-UK tax treaty gives the UK (resident country) the sole taxing right for interest. Accordingly, only the UK can tax the income under Article 11 of the SA-UK tax treaty. Based on the UK domestic position with regards to the income from staking activities, it may be unlikely that the UK would want to tax the income under Article 11 of the SA-UK tax treaty as then it would be considered interest. Accordingly, under Article 3(2) of the SA-UK tax treaty, the UK may wish to tax the income under a different article such as business profits under Article 7, or other income under Article 20.

Article 7 of the SA-UK tax treaty deals with business profits and will need to consider if the UK resident carries on an enterprise in SA through a permanent establishment. If this can be argued, perhaps in a scenario where the UK resident conducts direct staking activities in SA and creates a permanent establishment, the income from such staking may be taxed in SA. If

no permanent establishment is present in SA, then the income remains taxable in the UK. In terms of Article 20 of the SA-UK tax treaty, the residence state is given the taxing right provided none of the previous articles of the SA-UK tax treaty applies.

If the facts were altered to allow for a SA resident to conduct staking activities in the UK, then SA is considered as the residence state, and would have sole taxing rights under the SA-UK tax treaty. Here it will be likely that the income from indirect staking would be classified as interest and taxed under Article 11 of the SA-UK treaty.

6.5. Conclusion

The exemplar presents simple facts of a UK resident participating in crypto staking activities with an intermediary in SA. The return from such staking activities has been analysed in this study and based on the definition of interest in SA tax law approach as well as the wide interpretation of the definition of interest under the OECD Model which reasonable suggests that the income from staking crypto assets will likely be classified as interest.

Accordingly, SA as the source state would wish to apply the domestic WTI provisions, however Article 11 of the SA-UK tax treaty gives the residence state the exclusive taxing right on interest. Thus, only the UK can tax the income from staking activities when arising from an SA source and accruing to a UK resident under the SA-UK tax treaty.

Given that the UK has issued guidance on the returns from staking activities, it is unlikely that the UK would proceed to tax the UK resident under Article 11 and may likely apply Article 7 or Article 20 of the SA-UK tax treaty. It should be noted that if the tax treaty was with a different jurisdiction and that gives SA the source taxing right, then SA would have been able to levy WTI to the interest and the tax treaty would likely reduce the amount of WTI to be withheld.

7. CONCLUSION

It is a firm principle in taxation that a taxpayer has the right to structure their tax affairs within the constraints of the law in order to pay the least amount of tax.[199] Together with this right, taxpayers are also entitled to tax certainty as explained by Smith:

> *'The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid all ought to be clear and plain to the contributor and to every other person.'*[200]

The rise of activity within the crypto asset space has drawn the attention of various tax authorities and taxpayers around the world. As expected, this has also caused various debates over the appropriate tax treatment and the OECD report recognises that,[201] in some countries, there is a degree of uncertainty over how virtual currencies are defined which may result in different interpretations of the tax treatment. Accordingly, guidance from tax authorities around the characterisation of crypto assets is of foundational importance for understanding how they fit within existing tax systems.[202] Additionally, it is important for jurisdictions to consider the income tax consequences of crypto assets and DeFi transactions particularly as DeFi participation increases.[203] Given the complexity of blockchain technology and the various transactions within DeFi, taxpayers themselves are uncertain as to how they must be tax compliant and lack any guidance from their tax authorities.[204]

This study set out to determine whether the income from staking crypto assets can be considered as interest under SA tax law and if the WTI provisions could apply. In addition, it was also considered if Article 11 of the OECD Model would find application based on the definition of interest and the income from staking crypto assets.

Chapter 2 provided insight to the function of crypto assets and DeFi, specifically focusing on staking crypto assets. Essentially, DeFi can be considered as an alternative financial system based on blockchain and crypto assets, using applications that aim to provide financial services. Staking crypto assets emerges as popular DeFi activity and more specifically indirect staking that occurs on DeFi platforms and allows for users to deposit their crypto assets and in return earn rewards over the period. The requirement is for the staker or user to allocate a principal

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[199] *Duke of Westminster v IRC* 1936 19 TC 490.
[200] Smith (1988) op cit note 33 at p 644.
[201] OECD (2020) op cit note 6.
[202] Ibid.
[203] Parsons S & Schoonwinkel H op cit note 130.
[204] Scarcella L "Direct Taxation Aspects of Cryptoassets" in D Weber (ed) *The Implications of Online Platforms and Technology for Taxation* sec. 7 (IBFD 2023).

amount of crypto assets and with this allocation, the platform will participate in staking protocols that determine the return based on various parameters. This is seen as a passive activity as the user delegates the actual staking activity to the intermediary who then performs the actual staking and provides the user with a return.

The requirements of the WTI provisions are reviewed in Chapter 3. Importantly for WTI to apply, an amount must be defined as interest under section 24J of the Act. The definition contains two main parts, the general application as part (a) while the more contractual application is found under part (b). The general application requires an amount to be either 'interest' or 'similar finance charges' and in respect of a 'financial arrangement'. In terms of common law, the underlying principle of interest is consideration for the advancement of credit while the term 'similar finance charges' will include any amounts that are, in substance, the same kind or nature as interest. With the understanding that a 'financial arrangement' has a general meaning of a contractual arrangement of finance or credit, in the context of crypto assets, the amount may be seen to arise from such contractual arrangement and thus meet the definition of interest.

Under part (b) of the definition, no reference to the term 'interest' is made, rather the amount must represent compensation payable by a borrower to the lender in terms of a lending arrangement. The lending arrangement exists when a lender and borrower have an agreement where the lender lends an instrument to the borrower and the borrower returns the same instrument or equivalent quality and quantity to the lender. Thus, it seems likely that in the context of crypto assets, the amount may be considered as interest under both parts and thus should find application under at least part (a) or (b). Reasonably, the income from indirect staking could likely meet the definition of interest in section 24J of the Act, and thus the WTI provisions may apply. Accordingly, in the case of WTI applying, a 15 per cent WTI will be levied on the transaction but the relevant tax treaty also needs to be considered which may reduce the WTI.

An overview of the approach taken by SA on DeFi transactions is considered in chapter 4. This is followed by the application of the SA WTI provisions to the income from staking activities and considers an example of indirect staking of crypto assets. The analysis finds that it is likely for the return from staking crypto assets with an intermediary, to be defined as interest and could trigger the WTI provisions. However, where direct staking occurs, it is likely that the return will be taxed as normal income.

In chapter 5, the definition of interest is considered from an international perspective with specific reference to Article 11 of the OECD Model. The definition of interest under Article 11 of the OECD Model is given a very wide interpretation and does not make reference to money or a currency but rather recognises that interest arises from a debt-claim which also indicates there is a legal basis for debt to be repaid. The OECD also considers that there may be non-traditional financial situations that can be defined as interest to the extent that a loan is considered to exist under a 'substance over form' rule, an 'abuse of rights ' principle, or any similar doctrine.[205]

Article 11 of the OECD Model grants the source state limited taxing rights and does not reference domestic law within the definition of interest, however in practice many countries adopt the 1963 OECD Draft language or some similar wording which refers to the source state domestic law to consider the definition of interest. Chapter 5 concludes that with indirect staking, a legal obligation for repayment is present and accordingly there is a debt-claim. Income from this debt claim is likely to be classified as interest under Article 11 of the OECD Model.

In order to provide a practical example, an exemplar is provided in chapter 6 which considers if income from indirect staking can be classified as interest under Article 11 of the SA-UK tax treaty. The treaty is largely based on the OECD Model and contains the most recent definition of interest referring to income from a debt-claim of any kind. However, the SA-UK tax treaty deviates from the OECD Model by giving the exclusive taxing right to the residence state. The chapter concludes that SA as the source state would wish to apply the domestic WTI provisions, however Article 11 of the SA-UK tax treaty gives the residence state the exclusive taxing right on interest. Thus, only the UK can tax the income from staking activities when arising from an SA source and accruing to a UK resident under the SA-UK tax treaty. Interestingly, the UK for example agrees there are similarities between the return from DeFi activities (which includes staking) and the traditional form of interest, however they do not view the return from staking activities as interest and accordingly none of the UK interest provisions may apply.

This analysis highlights that while the interest definition under Article 11 of the OECD Model may apply to only indirect staking activities there is still much uncertainty that exists and the respective countries domestic laws and their tax treaties need to be considered

[205] Vogel op cit note 162 at 730.

wholistically. The complexity of the technology and uncertainty of tax authorities on how to tax income from crypto assets increase the risk of abuse and that jurisdictions are exploited and thus it will be beneficial for all stakeholders to develop an appropriate tax response to income from crypto assets and specifically those involved with DeFi activities.[206]

As the development of crypto assets continues and adoption of non-traditional financial situations rise, the international tax law needs to bear in mind the history of how definitions come to their current form and consider the case law that will help further develop the definitions in these scenarios. Further possible research on crypto assets and staking could consider how the source of staking activities is determined as well as beneficial ownership requirements and if these can be met via the various methods of staking (direct vs indirect). The tax mismatches that may occur between countries and the use of other articles under the OECD Model to resolve these should also be considered. Continued guidance from tax authorities on the taxation of crypto assets and the various transactions related to crypto assets will be welcomed.

[206] See, for example, Baer K et al., *Taxing Cryptocurrencies* in Working Paper 2023/144 (2023). Available at: https://www.imf.org/en/ Publications/WP/Issues/2023/06/30/Taxing-Cryptocurrencies-53551 0?cid=bl-com-WPIEA2023143 (Accessed 24 August 2024).

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