

The creation of a permanent establishment in South Africa as a result of the activities or presence of a partner or partners in South Africa

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Esther van Schalkwyk

12 March 2017

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Abstract

This dissertation seeks to establish whether the presence or activities of a partner or partners in South Africa creates (or is at risk of creating) a permanent establishment for that partner, the partnership or the co-partners in South Africa.

At the outset, the major legal and fiscal consequences of a partnership under South African law are investigated. The unique legal and fiscal treatment of a partnership as a mere aggregate of persons that is treated as fiscally transparent under South African law is relevant to determine the potential application of double taxation agreements to partnerships or their partners. Once the terms of a double taxation agreement are found to apply in the circumstances, the creation of a permanent establishment in terms thereof becomes relevant.

The different types of partnerships and partners under South African partnership law are set out and their differentiating characteristics analysed in an effort to identify whether the activities or presence of certain partners are more at risk of giving rise to a permanent establishment than others. In a commercial context, the important distinction is drawn between ordinary and extraordinary partners as very different commercial consequences attach to these partners. In particular, whereas ordinary partners automatically derive an implied authority or mutual mandate to manage the business of the partnership as agents of their co-partners by virtue of the partnership agreement, extraordinary partners are excluded from the mutual mandate. The implied authority amongst partners becomes particularly relevant when considering one of the alternative tests for creating a permanent establishment that appear in the prevalent model tax conventions commonly used in the South African context, in terms of which the existence of authority is one of the required elements for the creation of a permanent establishment.

The special rules surrounding the source of partnership income is investigated as a means of establishing jurisdiction to tax under South African domestic source rules. The impact of legislation on the South African source rules pertaining to partnerships as developed under the common law is critically analysed and the relevance of source rules in the permanent establishment context is evaluated. It is submitted that it is premature to consider the rules surrounding the creation of a permanent establishment under the terms of a double taxation agreement before it is established that the relevant contracting state has the requisite jurisdiction to tax and furthermore that the terms of that double taxation agreement apply to the matter at hand.

Finally, the relevant articles of the model tax conventions commonly used in the South African context are discussed with specific focus on the unique attributes of a partnership that may impact on the creation of a permanent establishment for the partner or partners by virtue of the presence or activities of a partner or

the partners in South Africa. The risk of creating a permanent establishment by virtue of the presence or activities of an ordinary partner in South Africa is contrasted with that of an extraordinary partner. It is concluded that the activities or presence of ordinary partners (as opposed to extraordinary partners) are particularly at risk of creating a permanent establishment in South Africa, although it is acknowledged that certain requirements will have to be met on the facts of each case before a permanent establishment will be found to exist.

Glossary / Abbreviations

Abbreviation	Full term
AD	Appellate Division
Art / Arts	Article / Articles
BPR	Binding Private Ruling
DTA	Double Taxation Agreement
DTC	Davis Tax Committee
IBFD	International Bureau of Fiscal Documentation
OECD	Organisation for Economic Co-operation and Development
OECD MTC	OECD Model Tax Convention on Income and on Capital
OECD Partnership Report	The Application of the OECD Model Tax Convention to Partnerships
Para. / Paras.	Paragraph / Paragraphs
PE	Permanent establishment
S / Ss	Section / Sections
SADC	Southern African Development Community
SADC MTC	SADC Model Tax Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income
SARS	South African Revenue Service
SCA	Supreme Court of Appeal
The Act	Income Tax Act, 58 of 1962, as amended from time to time
TCAA	Taxation Laws Amendment Act
UN	United Nations
UN MTC	UN Model Double Taxation Convention between Developed and Developing Countries
VAT	Value-Added Tax

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1. Introduction to the law of partnership

1.1 The relevance of conflict of laws in the context of taxation

A partnership is a form of business enterprise that has stood the test of time (Olivier & Honiball, 2011:162). The legal consequences of forming a partnership flow from the law of partnership as developed over many years. In the context of cross-border partnerships¹ that have a presence in more than one jurisdiction, the question arises which law of partnership should determine the legal consequences of that partnership.

Sovereign states, like South Africa, enjoy national sovereignty over their territory (Edwards & Kahn, 2003:para. 281). As a result, domestic laws invariably differ between countries although governing similar subject matters. Countries have developed their own rules of private international law, also referred to as conflict of laws, to determine which country's domestic laws should be applied to resolve dispute involving foreign elements (Edwards & Kahn, 2003:para. 281). Vogel points out that private international law remains relevant in the context of taxation insofar as taxation depends on relationships emanating from private law, for example establishing ownership (1986:13).

Private law is that part of a country's substantive law which governs the (horizontal) relationships between different legal subjects and can be contrasted with public law which governs the (vertical) relationship between legal subjects and the state (Davel & Jordaan, 2005:1). The so-called "proper law" of a contract, ie the domestic law governing the contract, is based on an agreement between the parties as to which country's laws should govern their contract (Edwards & Kahn, 2003:para. 328). However, subjects of a given state are not at liberty to choose between the fiscal rules of different jurisdictions by way of a choice of law clause because fiscal rules flow from the vertical relationship between the state and its subjects (not from the horizontal relationship between subjects that can usually be varied by agreement).

Each country's ability to impose taxes flows from its national sovereignty (Olivier & Honiball, 2011:1). Consequently there is no set of uniformly applicable international taxing rules; rather, as noted by Olivier and Honiball, the concept of international tax relates to the international features of domestic tax laws (2011:1).² This paper is specifically written from a South African viewpoint and the particular focus is on the considerations that should be relevant to a South African court when considering the taxation of the income of a cross-border partnership in the hands of the partnership or its partners.

¹ The term "cross-border partnership", as used throughout this paper, envisages some level of activity or presence of a partner or partners in South Africa as well as outside South Africa.

² Vogel and Rust describe the concept of international tax law as referring to the domestic and international rules governing so-called "cross-border situations" (2015:13), whereas Olivier and Honiball call the term international tax a "misnomer" as taxes are only imposed by countries in terms of their own domestic legislation and not at an international level (2011:1).

Countries only impose and usually only collect³ taxes in accordance with their own domestic tax laws (Vogel, 1986:14). The levy of taxes by a state is therefore in essence not a conflict of laws that can be resolved by the rules of private international law but rather represents a state exercising its sovereignty over its territory or subjects. States may only impose taxes on income if the particular state is sufficiently connected to the income under consideration (Olivier & Honiball, 2011:9). States may therefore impose taxes on income if, under that state's domestic laws, it has "residence jurisdiction" over the taxpayer involved or alternatively "source jurisdiction" over the income (Olivier & Honiball, 2011:9-10).⁴ Special rules have developed in South African domestic law regarding the source of partnership profits, which will be considered in chapter 4 below.

Although the partnership is a common form of business enterprise around the world, the legal consequences and tax treatment of partnerships often vary significantly between different jurisdictions. When a court is called upon to determine the tax consequences of a foreign cross-border entity, the court is likely to consider the legal aspects of that entity under the (foreign) law of its country of formation and to tax that entity according to the domestic tax rules applicable to the domestic business form that is most similar to that foreign entity (Avery Jones et al., 2002:289).⁵ When confronted with a foreign cross-border partnership, a South African court should therefore compare the attributes of that foreign body with the attributes of a South African domestic partnership to determine whether the business should be taxed as a partnership in the South African sense of the word. Assuming the foreign entity is regarded as the equivalent of a partnership in terms of South African law or a foreign partnership, the court should naturally also have regard to any statutory provisions in South African domestic law that may have an impact on the taxation of partnerships.

A cross-border partnership and its partners will usually also be subject to the partnership and fiscal laws of a foreign country, which could entail a different legal and tax treatment to South Africa. Bodies of persons that are taxed at entity level in one jurisdiction but treated as fiscally transparent in a different jurisdiction, such as partnerships or trusts, are often referred to as "hybrid entities" (Oguttu, 2009:51). In recent years, certain amendments have been made to South African fiscal legislation in an effort to reduce the occurrence of hybrid entities in the context of partnerships, as will be discussed in the next chapter below.

International transactions often lead to double taxation. Juridical double taxation, also referred to as legal double taxation, arises where a taxpayer is taxed on the same income on more than one occasion (Olivier

³ In *COT, Federation of Rhodesia v McFarland*, 1965 1 All SA 389 (W), 27 SATC 15, the court reiterated at 18 that "fiscal power is an attribute of sovereignty" and accordingly refused to enforce a foreign judgment in South Africa of taxes owing under Rhodesian tax laws. Countries may, however, contract out of the revenue rule (which is the rule of international law that courts will not enforce the revenue laws of other countries), as more recently illustrated in *Krok v CSARS*, 2015 JOL 33672 (SCA), 78 SATC 1.

⁴ This may collectively be referred to as "jurisdiction to tax". See in this regard Olivier and Honiball (2011:11-48).

⁵ This approach is referred to as the "closest internal law equivalent" (Avery Jones et al., 2002:289). A few countries do not follow this general rule (Avery Jones et al., 2002:289) but South Africa does not seem to be one of them. This also appears from the reference to the closest internal law equivalent approach by South African academic writer, Oguttu (2009:52-53).

& Honiball, 2011:6).⁶ Cross-border partnerships that constitute hybrid entities are particularly at risk of giving rise to economic double taxation due to the imposition of taxes by different jurisdictions at different levels (for example, imposing taxes at partnership level in one jurisdiction whereas another jurisdiction may tax the individual partners).

A common method of reducing the occurrence of juridical double taxation is the entering into of double taxation agreements (hereafter referred to as “DTAs”) between different states. South Africa has entered into a number of DTAs with other states in addition to promulgating certain provisions in South African domestic law aimed at the avoidance of double taxation (Olivier & Honiball, 2011:6). DTAs do not introduce the right to tax but rather limit a country’s ability to impose taxes in terms of its domestic laws so as to avoid double taxation and prevent tax evasion in situations where the particular DTA applies (Vogel & Rust, 2015:28-29). The application of DTAs therefore does not lead to a conflict of laws as the countries that are involved will only impose taxes based on their own domestic tax laws albeit in a limited fashion (Vogel & Rust, 2015:23).

In order to promote uniformity across DTAs, several international organisations have developed model tax treaties⁷ (hereafter referred to as “MTCs”) as a basis for negotiating DTAs (Olivier, 2002:868). Building on the preparatory work of the League of Nations, the Committee on Fiscal Affairs of the Organisation for Economic Co-operation and Development (hereafter referred to as the “OECD”) first issued a Draft MTC in 1963 and has since then published updated versions at an increasing pace (Vogel & Rust, 2015:20-21). The OECD MTC⁸ currently enjoys the widest recognition as the basis for negotiating tax treaties around the world (Olivier & Honiball, 2011:268). Although South Africa is not a member of the OECD, it is named in the full version of the OECD MTC and Commentary as one of 33 non-OECD jurisdictions which generally agree with the OECD approach but have otherwise noted their positions where they disagree (OECD, 2014:p-3-p-4). The United Nations (hereafter referred to as the “UN”) has developed its own MTC. The UN first published a Draft MTC in 1980. The UN MTC⁹ follows the general wording and structure of the OECD MTC, however, it provides a more suitable basis for the negotiation of tax treaties with developing countries as it proposes certain articles that are more favourable to the country having source jurisdiction as opposed to the country having residence jurisdiction (UN, 2011:vi). An important development in the South African context is the Draft MTC that was first proposed by the Southern African Development Community (hereafter referred to as “SADC”) in 2001. The SADC MTC¹⁰ is based on the OECD MTC while including

⁶ The International Bureau of Fiscal Documentation defines juridical double taxation as “the imposition of comparable taxes by two (or more) tax jurisdictions on the same taxpayer in respect of the same taxable income or capital” (IBFD, 2016). Juridical double taxation should be distinguished from economic double taxation, which refers to the situation where the same income is taxed more than once but in the hands of different taxpayers (Olivier & Honiball, 2011:6).

⁷ Also referred to as model tax conventions.

⁸ Model Tax Convention on Income and on Capital. The current version was published in 2014.

⁹ Model Double Taxation Convention between Developed and Developing Countries. The current version was published in 2011.

¹⁰ Model Tax Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. The current version was published in 2011. Krause refers to a 2013 version of the SADC MTC (2015:11), however, this later version does not seem to be publicly available.

elements of the UN MTC (SADC, 2011:2). Since the SADC MTC was finalised in 2011, it is likely that South Africa, as a member of the SADC, will increasingly rely on the articles of the SADC MTC when negotiating DTAs in future (Olivier & Honiball, 2011:5). Although there are several other MTCs that are not mentioned here,¹¹ the MTCs published by the OECD, UN and SADC seem to be the most relevant in the South African context (currently in that order).¹²

MTCs are not binding documents but rather form the basis for the negotiation of DTAs between countries insofar as those countries agree to the articles of the relevant MTC. Once two or more countries have validly entered into a DTA, that DTA binds the signatories to the DTA as a legally enforceable document (Vogel & Rust, 2015:7).

With each update of an MTC, the OECD, UN and SADC publish detailed commentaries. Like the MTCs, the commentaries do not constitute binding documents. However, the commentary on the widely recognised OECD MTC (hereafter referred to as the “OECD Commentary”) serves as a useful guide for the interpretation and application of that MTC and any ensuing DTA (Vogel & Rust, 2015:7). The OECD Commentary forms the basis of the commentaries on the UN MTC and the SADC MTC (hereafter referred to as the “UN Commentary” and the “SADC Commentary” respectively), with added variations based on the relevant MTC. When interpreting a particular DTA, a South African court, although not bound by the relevant commentary, may have regard to the relevant commentary insofar as it assists the court in the interpretation and application of the provisions contained in the DTA. This was notably illustrated in *SIR v Downing*, 1975 (4) SA 518 (A), 37 SATC 249, where the Appellate Division (hereafter referred to as the “AD”) relied on the provisions of the OECD Commentary at the time to determine whether a permanent establishment (hereafter referred to as a “PE”) had been created in South Africa in terms of the DTA between South Africa and Switzerland.¹³

In its report entitled *The Application of the OECD Model Tax Convention to Partnerships* (hereafter referred to as the “OECD Partnership Report”), the OECD identified the divergent tax treatment by different jurisdictions of cross-border partnerships and other hybrid entities as an overriding difficulty in the application of DTAs to these bodies (OECD, 1999: R(15)-6). Whereas some jurisdictions (such as South Africa, as will be discussed in 1.2.2 below) treat partnerships as “fiscally transparent” entities, other jurisdictions impose tax on the partnership itself as a taxable entity (OECD, 1999: R(15)-6).

¹¹ Such as the United States MTC and technical explanation thereof as well as MTCs developed by other countries, including South Africa (Olivier & Honiball, 2011:272). According to research conducted by Krause, the South African MTC combines the MTCs of the OECD, UN and SADC (2015:11). The so-called South African MTC does not seem to be a publicly available document.

¹² Given that the OECD MTC is currently the most widely recognised MTC followed by the UN MTC (Olivier & Honiball, 2011:268) and the SADC MTC is expected to be increasingly relied on by South Africa when entering into DTAs in future (Olivier & Honiball, 2011:5).

¹³ More recently, the Tax Court in ITC 13276 had to consider whether a PE was created by way of the rendering of services by employees of a foreign company in South Africa. Despite remarking that “[i]f any treaty contains the same article as that of the OECD Model then it would not be uncommon to rely on the commentary of the OECD Model to interpret that article”, the court ultimately disregarded the approach as recommended by the commentary. Note that decisions of the Tax Court do not create binding legal precedent in South Africa.

1.2 South African domestic partnerships

1.2.1 The legal nature of a partnership

The term partnership is believed to have its origin in the Latin word “partarius” meaning “one who shares with another” (Henning, 2006:para. 252). In *Pezzutto v Dreyer*, 1992 2 All SA 81 (A) at 91, the AD described a partnership as “the carrying on of a business (to which each of the partners contributes) in common for the joint benefit of the parties with a view to making a profit”.

Although other common business forms, such as companies and close corporations, are allowed to have only one member, a partnership must have at least two members at any given time (Olivier & Honiball, 2011:162). Partnerships may be entered into between natural or juristic persons or a combination of both (Olivier & Honiball, 2011:162) and there is no longer a limit of 20 partners under South African law.¹⁴

The essential requirements, commonly referred to as the *essentialia* of a partnership can be described as the special characteristics of a partnership agreement that distinguishes it from all other agreements (De Wet & Yeats, 1964:559). The *essentialia* of a partnership were accepted into the South African common law in the seminal case of *Joubert v Tarry & Co.*, 1915 TPD 277, where De Villiers JP at 281 accepted Pothier’s four essential requirements as the *essentialia* for establishing a partnership in terms of South African law. The *essentialia* are: First, each partner must make, or bind himself to make, some contribution to the partnership, “whether it be money, or his labour or skill”. Secondly, the business of the partnership must be carried on for the benefit of all the partners. Thirdly, the object of the partnership must be to make a profit. Fourthly, there must be a legitimate contract establishing the partnership.¹⁵

A partnership is accordingly a particular kind of contract that is entered into between two or more partners as the parties to the contract. A partnership contract must therefore meet the ordinary validity requirements of the law of contract before a partnership can come into existence (De Wet & Yeats, 1964:557). The general requirements of a binding contract include, in addition to consensus between the parties, that the parties must have the capacity to enter into the agreement, the anticipated performance must not be impossible, and adherence to the principle of legality and the relevant formalities to contract (Van der Merwe et al., 2007:8). The AD in *Bester v Van Niekerk*, 1960 (2) SA 779 (A) held that the fourth of Pothier’s requirements does not in fact constitute an *essentialia* of a partnership but rather an ordinary validity

¹⁴ Section 30(1) of the Companies Act, 61 of 1973 (hereafter referred to as the “1973 Companies Act”) prohibited partnerships for the purpose of carrying on a business or making a gain that had more than 20 members. Such a partnership would terminate upon the limit of 20 members being exceeded (Henning, 2006:para. 269). The 1973 Companies Act was repealed by s 224 of the Companies Act, 71 of 2008 (hereafter referred to as the “2008 Companies Act”) with effect from 1 May 2011.

¹⁵ There is some controversy as to whether the fourth requirement truly qualifies as one of the *essentialia* of a partnership. Tudor’s English translation of Pothier’s fourth *essentialia* reads: “[T]he business which is its object, and for which the contracting parties associate themselves, should be lawful, and that the profit which they propose to draw therefrom should be a lawful profit” (1854:11).

requirement applicable to all types of contracts.¹⁶ De Wet and Yeats (1964:559) therefore conclude that the essential requirements of a partnership include a contribution by each partner to the partnership business, which business is to be carried on for the joint benefit of the partners with the intention of making a profit.¹⁷ Although the object of a partnership agreement must be lawful, this ordinary validity requirement does not constitute an *essentialia* of a partnership (Bamford, 1982:18).¹⁸

South African law recognises several different types of partnerships (Henning, 2006:para. 256). Partnerships may be divided into universal *versus* particular partnerships and ordinary *versus* extraordinary partnerships (Davis et al., 2011:326). A universal partnership constitutes an overall pooling of assets or income whereas a particular partnership will have definite parameters (Davis et al., 2011:326). In a commercial context, the distinction between ordinary and extraordinary partnerships is vital. Under the common law, extraordinary partnerships include anonymous partnerships and *en commandite* partnerships (De Wet & Yeats, 1964:584). While ordinary partners are exposed to the normal consequences of a partnership agreement, anonymous (also referred to as silent) or *en commandite* partners are able to limit their exposure (Henning, 2006:para. 258). As a result, the involvement of extraordinary partners in the business of the partnership is usually limited.

Where the *essentialia* of a partnership are present (which applies to all types of partnerships), the court in *Joubert v Tarry* held at 281 that a court must hold a partnership to exist unless the parties to the contract have agreed otherwise.¹⁹ As can be seen from *Sacks v CIR*, 1946 AD 31, 13 SATC 343, in which the AD recognised a verbal partnership agreement, a partnership contract need not be in writing. Save for having to conclude a valid contract that meet the relevant *essentialia*, a partnership contract is not subject to any special formalities. Persons entering into a partnership agreement may of course agree to certain formalities, for example, that their partnership agreement must be in writing and signed by all the partners (Henning, 2006:para. 271). When compared with, for instance, incorporating a company in terms of the 2008 Companies Act, it seems that a partnership remains largely an unregulated form of a business enterprise and need generally not even be registered.²⁰

¹⁶ This principle as established in *Bester v Van Niekerk* has been reiterated in such recent case law as *Butters v Mncora*, 2012 JOL 28653 (SCA).

¹⁷ De Wet and Yeats criticise the court's concluding remark in *Joubert v Tarry* at 281 that "something" may show that the agreement between the parties is not a partnership, notwithstanding that the essential requirements of a partnership may have been met (1964:559).

¹⁸ See further Bamford (1982:18-21) for a discussion of lawfulness as a requirement of any partnership. Today, the Constitution of the Republic of South Africa, 1996 is the supreme law of South Africa and s 39(2) thereof requires that the courts develop the common law in a manner that promotes the spirit, purport and objects of the Bill of Rights.

¹⁹ For a contrary view, see *Isaacs v Isaacs*, 1949 (2) All SA 147 (C), where the court remarked that not every contract that meets the *essentialia* of a partnership will necessarily be held to constitute a partnership. See also *Hoheisen v CIR*, 5 SATC 207 1931 CPD, in which it was held that a partnership contract must be given effect to before a partnership can be said to exist. Based on the dictum in *Hoheisen*, Olivier and Honiball recognise the parties' intention as a possible fifth requirement to establishing a partnership (2011:163). It is submitted that, once the parties have entered into a valid contract of partnership that meets Pothier's *essentialia*, a partnership comes into existence irrespective of whether the parties choose to label the arrangement as a partnership.

²⁰ Bamford noted that partnerships need not be registered (1982:24), which statement still holds true today, more than three decades later. See De Wet and Yeats for a brief discussion of the registration requirements that existed in respect of certain partnerships established in Natal, Transvaal and the Cape Province prior to South Africa becoming a Union (1964:557-558).

The result of such an informal system regulating partnerships is, however, that parties may enter into a partnership agreement without realising the implications thereof. Indeed, in *Joubert v Tarry* a partnership was found to exist notwithstanding that the parties to the agreement chose to label it as a lease agreement. Parties may furthermore not realise that even a single transaction could amount to a partnership if the relevant *essentialia* of a partnership are met, as was expressly held by the AD in *Bester v Van Niekerk* at 785. More recently, in *Butters v Mncora*, 2012 JOL 28653 (SCA), the Supreme Court of Appeal (hereafter referred to as the “SCA”) held at para. 18 that a tacit universal partnership had been entered into between two cohabitees and confirmed that all partnerships, including universal partnerships, can be entered into tacitly by the conduct of the parties (in spite of previous views to the contrary).²¹

Where a partnership has been created in terms of South African domestic law, it is not regulated by any one piece of comprehensive legislation (as compared to South African companies that are largely regulated in terms of the 2008 Companies Act).²² Rather than legislation, the primary source of South African partnership law is the common law (Henning, 2006:para. 254). The South African common law is in substance based on Roman-Dutch law. In the context of partnership law, the common law was influenced significantly by the writings of the French legal writer, Pothier (Henning, 2006:para. 254).

With the exception of Scotland and certain Delaware partnerships, most common law jurisdictions do not regard partnerships as legal persons having legal capacity (Avery Jones et al., 2002:298). According to Henning, the South African courts (like most other common law countries) have generally followed the aggregate approach (as opposed to the entity approach) in dealing with partnerships (2014:150). Under the aggregate approach, a partnership is not treated as an entity in its own right, but rather as an aggregate of persons (Henning, 2014:150). As the partnership is only an aggregate of persons, all partnership property is directly owned by the partners in undivided shares (Henning, 2006:para. 277). Each partner’s share in the partnership property is determined by the terms of the partnership agreement (De Wet & Yeats, 1964:571). Any change in the identity of the partners (for example, when a partner exits the partnership or a new partner is introduced) results in a dissolution of that partnership and the creation of a new partnership between the remaining partners (Davis et al., 2011:332). In terms of the aggregate approach the legal position is therefore established by looking through the partnership and considering the attributes of the individual partners. On the other hand, the entity approach, which is followed in many civil law countries, regards the partnership as a quasi-person in its own right (Henning, 2006:para. 277).

²¹ Earlier contradictory views that a partnership *universorum bonorum* could only come into existence by way of an express agreement between the parties, was, for instance, followed in *Annabhay v Ramlall*, 1960 (3) SA 802 (D) (Henning, 2006:para. 257 fn. 34).

²² There have been several calls for the development of partnership legislation (Henning & Snyman, 1997:685). Although a special limited partnership was introduced by way of legislation in the Cape Province and Natal prior to South Africa becoming a Union, this legislation has since been repealed.

In certain instances even a South African partnership may be treated as an entity in its own right apart from the partners.²³ This only applies where specific provision is made, usually by way of statute, to override the general principle flowing from the aggregate approach. Although the courts have in the past indicated that partnerships could be afforded legal personality in some respects, the *ratio* of such case law does not seem to extend beyond the special treatment of partnerships in the law of insolvency.²⁴ In the context of civil procedure, the SCA in *DF Scott (EP) (Pty) Ltd v Golden Valley Supermarket*, 2002 (3) All SA 1 (A) reiterated that the procedural rules of court do not transform a partnership into a legal entity.

In terms of South African common law, a partnership is therefore not regarded as a legal entity separate from the partners carrying on the business of the partnership (De Koker & Williams, 2016:para. 11.1). Watermeyer CJ, writing for the AD in *Sacks*, confirmed at 40 that partnership assets are owned by all the partners jointly in undivided shares. The court further remarked that, subject to the partnership agreement, all partnership receipts and accruals are acquired by the partners jointly in undivided shares and the partners only become entitled to their proportionate share of the profit once the partnership accounts have been rendered in accordance with the partnership agreement. The result is that the income flows through the partnership to be taxed only in the hands of the partners themselves.

1.2.2 Introduction to the taxation of partnership income²⁵

A partnership essentially involves the conducting of a business by way of a joint effort or venture²⁶ for the purpose of realising a profit. This raises the question of how partnership profits should be taxed.

That a partnership is not a separate legal entity was upheld in an income tax context in *Chipkin (Natal) (Pty) Ltd v CSARS*, 2005 (5) SA 566 (SCA), 67 SATC 243. The SCA in *Chipkin* confirmed at 30 that a partnership is not a taxpayer for South African income tax purposes. This is because a partnership is not a legal entity

²³ For examples of "exceptions or quasi-exceptions" to the aggregate approach, which notably includes the law of insolvency and the law of civil procedure, see Henning (2014:152-167). Avery Jones et al. note that common law jurisdictions, although usually not regarding partnerships as legal entities, often treat partnerships as commercial entities from a practical viewpoint (2002:298).

²⁴ In *Silbert & Co. v Evans & Co.*, 1912 TPD 425, the Transvaal Provincial Division, in an insolvency matter, noted at 441 that partnerships are treated as separate legal persons in some respects. In the subsequent case of *Potchefstroom Dairies and Industries Co., Ltd. v Standard Fresh Milk Supply Co.*, 1913 TPD 506, two of the judges who formed part of the bench in *Silbert* considered the legal nature of a partnership based on *Silbert*. Bristowe J went as far as stating at 514 that "a partnership though not a corporate individual is so far analogous to a *persona* that it may be called a *quasi-persona*." With respect, this general statement appears to be an undue extension of the *ratio* in *Silbert*, which was limited to the position of partnerships in the law of insolvency. Moreover, the court in *Potchefstroom Dairies* appears to have decided the matter at hand based on the role of the law of agency in the context of partnerships, which would render the court's general statements regarding the legal nature of a partnership *obiter* in nature.

²⁵ A brief overview of the income tax treatment of partnerships is given, which is not intended to be an exhaustive analysis of the tax consequences of a partnership. See, in this regard, Olivier and Honiball (2011:161-189).

²⁶ The term "joint venture" (abbreviated "JV") crops up in commercial transactions from time to time, often in collaborations between juristic persons. A joint venture is not in itself a form of a business enterprise under South African law. Joint ventures are often no more than contractual arrangements between a number of parties entered into for the purpose of working together on a particular project. A joint venture does not necessarily amount to a partnership in law, although a partnership may be created if a particular joint venture meets the *essentialia* of a valid partnership agreement (Olivier & Honiball, 2011:162). See, for instance, *Bester v Van Niekerk* in which the AD expressly held at 785 that a joint venture constitutes a partnership if Pothier's first three *essentialia* are met.

at common law and is not included in the definition of a “person”²⁷ in s 1 of the Income Tax Act, 58 of 1962 (hereafter referred to as “the Act”). In accordance with the judgment in *Chipkin*, a South African partnership is not taxed on the partnership income at partnership level, but rather the individual partners are taxed in their personal capacities at their individual rates on their proportionate share of the partnership income.²⁸ Olivier and Honiball are of the view that any amount flowing from a partnership to its partners can only be seen as a distribution of the partnership profit owing to that partner since a partnership itself does not have juristic personality under South African law (2011:186).

Partnerships are also subject to certain provisions in the Act that are aimed specifically at the taxation of partnerships. Section 24H of the Act is an important statutory provision that impacts on the taxation of partnerships in certain respects, especially in the context of extraordinary partnerships.²⁹ The provisions of s 24H seem to apply to a partnership as well as a “foreign partnership”³⁰ as defined in s 1 of the Act.

At common law the receipts and accruals of a partnership are considered to be acquired by the partners jointly in undivided shares. However, in terms of s 24H of the Act, the partnership income is deemed to have been received by or accrued to the individual partners in their proportionate shares on the date on which such income was received by or accrued to the partners in common.³¹ The partners are therefore deemed to have received their proportionate share of the income once it accrues to the partnership, which constitutes a deviation from the common law rule that was laid down in *Sacks* that partners only become entitled to partnership profits once accounts are rendered in accordance with the partnership agreement. Each partner is furthermore allowed to claim a proportionate share of any deduction or allowance that would have been available to the partnership had it been a taxable entity under the Act, in the same proportion as the income that was deemed to have been received by or accrued to the relevant partner.³²

When partners dispose of their share in the partnership or part thereof, they are in fact disposing of their share in the underlying assets of the partnership. Where the partner had claimed a proportionate share of deductions or allowances in relation to the partnership assets, that partner may realise a recoupment on the disposal of the relevant share in the underlying assets, as was the case in *Chipkin*.

²⁷ A “person” as defined in s 1 expressly includes an insolvent estate, the estate of a deceased person, any trust and any portfolio of a collective investment scheme while expressly excluding a foreign partnership.

²⁸ In delivering a concurring minority judgment in *Van der Merwe v SIR*, 1977 (1) All SA 591 (A), Trollip JA, with respect, inadvertently created the impression that a partnership could have a taxable income in its own right. The court in *Chipkin*, however, confirmed that a partnership could not have a taxable income as it is not a taxpayer for purposes of the Act.

²⁹ See Appendix A for the full wording of s 24H.

³⁰ See Appendix B for the definition of a “foreign partnership” in terms of s 1 of the Act. See further the discussion of the term “foreign partnership” in 2.4 below.

³¹ In terms of s 24H(5)(a).

³² In terms of s 24H(5)(b). Olivier and Honiball point out that this may create problems in practice, since partners may not necessarily share in the income and losses of the partnership in equal proportions (2011:170). See 2.5 below for a discussion of the limitations applicable to limited partners in terms of this section.

The South African approach to the taxation of the income of a partnership is therefore to almost disregard the partnership and to tax all the partners on their proportionate share of the partnership income.

Partnerships are popular in cross-border dealings as a result of their flexible nature and lack of formalities (Olivier & Honiball, 2011:162). One would also expect to see an increase in cross-border partnerships between persons of different jurisdictions due to globalisation. Where a partnership has a presence or activities in South Africa, the South African Revenue Service (hereafter referred to as “SARS”) may be entitled to collect taxes in respect of the appropriate share of the partnership profits.

As explained above, South Africa may generally impose taxes on income based on “residence jurisdiction” over the taxpayer or “source jurisdiction” over the partnership income (Olivier & Honiball, 2011:9-10). Special rules have developed in South African domestic law regarding the source of partnership profits in a cross-border situation. The source of partnership income will be considered in chapter 4 below, together with the impact of legislation that may have altered the South African common law in this regard.

A cross-border partnership, especially one constituting a hybrid entity, may naturally give rise to double taxation. This is because South Africa (for example, as the source country) and a foreign country (for example, as the partners’ country of residence) may both impose taxes in terms of their respective domestic fiscal laws. Economic double taxation will often be encountered in the context of cross-border partnerships as different jurisdictions may potentially impose taxes at different levels, depending on whether a particular jurisdiction regards the partnership as a taxable entity or not.

The application of a DTA (if one exists between the two countries) should not lead to a conflict of laws but may require one of the two countries to give up its right to tax the particular income in a particular situation in order to avoid double taxation.

The term PE is a concept that appears in DTAs and is now also used in South African domestic legislation in a few instances.³³ As will be more fully explored in chapter 5 below, the existence of a PE allows the country in which the PE is located to exercise its domestic taxing rights in respect of the profits that are attributable to the PE of a non-resident enterprise.

1.3 Research question

The main goal of this dissertation is to determine whether the presence or activities of a partner or partners in South Africa creates (or is at risk of creating) a PE for that partner, the partnership or the co-partners in

³³ Most notably, a PE is defined in s 1 of the Act with reference to the OECD MTC and the term appears in para. 2(1)(b)(ii) of the Eighth Schedule to the Act, in terms of which assets of non-residents are subject to South African capital gains tax if those assets are effectively connected with a PE of a non-resident in South Africa.

South Africa. The wider or secondary question of this dissertation, which is a necessary first step to answering the main research question, is whether South African law attaches unique or special legal and fiscal attributes to a partnership which may impact on the likelihood or relevance of creating a PE for the partners or partnership in South Africa.

The different consequences that attach to ordinary *versus* extraordinary partners will be considered in chapter 2 below. Throughout the rest of this paper a comparison will be drawn between ordinary *versus* extraordinary partners in answering the main research question as described above.

1.4 Research method

In order to answer the research question, data will be collected from primary resources such as the South African common law and domestic legislation addressing the legal nature and income tax treatment of partnerships. Secondary sources, such as academic writings, will also be relied on in the context of South African domestic partnership and related fiscal laws.

The term PE will be investigated in the context of a cross-border partnership. As the term PE has been extensively considered and debated on an international level, international sources such as academic writings and the relevant commentaries will be referred to insofar as they may be of assistance in the interpretation of the term PE in the context of cross-border partnerships.

1.5 Limitations of scope

The research question is aimed at determining the risk of creating a PE in South Africa by virtue of the presence or activities of a partner or partners in South Africa. An exhaustive analysis of the term PE as may be relevant in other contexts will therefore not be undertaken as this will not bring us any closer to answering the main research question. The consequences of having created a PE is a separate enquiry which is beyond the scope of this paper.

A detailed comparison between the law of partnership in civil law and common law jurisdictions is outside the scope of this paper. Rather, this paper will focus on the considerations that a South African court should take into account when deciding whether a PE of a cross-border partnership has been created in South Africa, assuming it will be the equivalent of a partnership in terms of South African law or a foreign partnership.³⁴ As such, the discussion of partnership law will be limited to South African domestic partnership law, which is what a South African court will rely on to determine the “closest internal law

³⁴ See 2.4 below for a discussion of the different circumstances in which a foreign entity will be classified as either a “foreign partnership” or a “company” in terms of the Act.

equivalent” (Avery Jones et al., 2002:289) when considering the taxation of a cross-border partnership, even if such a partnership was established outside of South Africa.³⁵ The unique or special legal and fiscal attributes that South African law attaches to a partnership as a business form will be investigated as well as the impact that such attributes may have on the likelihood or relevance of creating a PE for the partners or partnership in South Africa.

The analysis will further be limited to South African income tax considerations relating to partnerships and will not extend to other types of taxes, such as Value-Added Tax (hereafter referred to as “VAT”) as the income tax treatment of a partnership differs dramatically from the VAT treatment.³⁶

1.6 Structure of dissertation

Whether a PE of a partnership or its partners has been created in South Africa will depend on various factors that are domestic and international in nature. This paper will focus on some of the attributes of a partnership that are, in the writer’s view, particularly at risk of creating a PE and that should be relevant to a South African court in seeking to impose taxes on the income of a cross-border partnership or its partners.

The introductory chapter above briefly discussed the relevance of conflict of laws in the context of taxation. It was determined that a South African court is likely to treat a foreign entity as a partnership if it more closely resembles the domestic business form of a partnership as opposed to any other South African business form. The South African domestic law of partnership as developed under the common law was introduced in 1.2 above and the important conclusion was reached that South Africa levies taxes on partnership income in the hands of the partners themselves instead of taxing the partnership as a business at partnership level. This unique income tax treatment mainly flows from the fact that a partnership is not regarded as a legal person at South African common law, which may not necessarily be the case in a different jurisdiction. For the benefit of the reader who is reasonably informed of international tax concepts,³⁷ it is noted that whether a partnership is treated as a legal person and/or a taxable entity in a given state may be relevant, in particular, to whether a DTA should apply in the circumstances³⁸ and in determining the relevant enterprise in relation to which a PE may potentially be created in terms of the provisions of such DTA.³⁹

The South African common law recognises several different types of partnerships, which will be elaborated on in chapter 2 below. This is done in view of determining whether the different types of partnerships have

³⁵ This is reiterated by the OECD Partnership Report at R(15)-5 para. 14: “[T]he practice of most countries is to adopt the same approach as the one they apply in a purely domestic context. They will therefore apply their domestic tax classification to foreign entities on the basis of the foreign law’s legal characteristics of the entity.”

³⁶ For a discussion of some of the important VAT considerations in the context of partnerships, see Henning (2014:165-166).

³⁷ The meaning of certain technical terms used in this part 1.6 will be explained more fully in the relevant chapters below.

³⁸ See discussion in 5.1 below.

³⁹ See discussion in 5.2 below.

different legal and fiscal attributes which may impact differently on the creation of a PE for the partnership or partners in South Africa. In a commercial context it is particularly important to distinguish between ordinary and extraordinary partners. Extraordinary partners are sometimes referred to as limited or special partners and, as the name suggests, are not partners in the full sense of the word.⁴⁰ Another prevalent category of partnerships will also briefly be looked at, viz universal and particular partnerships. The impact of legislation on the taxation of partnerships in terms of current South African law will be analysed, in particular the introduction of s 24H and the definition of a “foreign partnership” in s 1 of the Act. For the reasonably informed reader it is noted that domestic provisions such as s 24H and the definition of a “foreign partnership” may potentially impact on a country’s jurisdiction to tax,⁴¹ which is established in terms of domestic rules. As discussed in 1.1 above, DTAs do not introduce the right to tax. As a result, the creation of a PE in terms of a DTA may be irrelevant from the perspective of a country seeking to impose taxes if that country does not possess the requisite jurisdiction to tax.

The important role that the law of agency plays in the partnership context will be discussed in chapter 3 below. The relevance of the law of agency to the creation of a PE is found in one of the alternative tests found in the MTCs commonly relied on by South Africa in negotiating DTAs, in terms of which a PE may be created in certain circumstances by virtue of persons having the authority to conclude contracts in the name of an enterprise and habitually exercising such authority, notwithstanding the absence of a fixed place of business.⁴² The extent to which the law of agency applies specifically in the context of partnerships will therefore be considered, including the potential application of the undisclosed principal doctrine to partnerships. The position of ordinary partners as agents of the partnership will be compared to that of extraordinary partners in order to determine whether extraordinary partners carry the same risk of creating a PE for the enterprise as their ordinary counterparts.

Chapter 4 will start looking at the taxation of partnerships from an international angle in considering the rules surrounding the source of partnership income as a basis for imposing taxes, also referred to as jurisdiction to tax. It is submitted that the possible existence of a PE under the provisions of a DTA should be irrelevant in circumstances where the particular state does not have the necessary jurisdiction to tax in terms of its domestic laws as DTAs do not introduce the right to impose taxes. Rules of source as developed under the South African common law will briefly be considered, with the focus on any special rules relating to the source of partnership income. The impact that s 24H of the Act may have on the source of partnership income will also be explored. Ultimately, careful consideration will be given to the relevance of the source of income in the context of the creation of a PE, so as not to confuse the two concepts.

⁴⁰ The terms “extraordinary”, “limited” and “special” will be used interchangeably throughout this paper in referring to partners that are not ordinary partners.

⁴¹ See discussion in 4.1 below.

⁴² See discussion in 5.3 below.

Chapter 5 will consider the term PE as a means of imposing tax by a country on the profits of a non-resident enterprise conducting business in that country. The enquiry into the term PE will be focused on the creation of a PE by way of the activities or presence of a partner or partners in South Africa. The relevant commentary will be consulted insofar as it may be helpful in determining the risk of creating a PE, specifically in the context of a cross-border partnership. Due to the relevance of the law of agency to partners, the alternative test for the creation of a PE where a person acts on behalf of an enterprise who has and habitually exercises an authority to conclude contracts in the name of the enterprise, is of great importance and will be critically evaluated. In addition, consideration will be given to the situation in which partners may render services in South Africa, as their contribution to the partnership or otherwise, which may also give rise to a PE in certain circumstances. Whether the rendering of services by partners in South Africa may give rise to a PE will be evaluated in light of the recent decision by the Tax Court in ITC 13276. Throughout chapter 5, the position of ordinary partners will be tested against that of extraordinary partners in considering the risk of creating a PE in South Africa.

The concluding chapter 6 will aim to answer the difficult question whether the presence or activities of a partner or partners in South Africa creates (or is at risk of creating) a PE for that partner, the partnership or the co-partners in South Africa in light of some of the unique attributes of a partnership.

Substantial research has on previous occasions been conducted on the application of DTAs to partnerships.⁴³ However, the taxation of cross-border partnerships as hybrid entities remains a complex matter and further research on the subject is warranted. In particular, the consequences of having created a PE for the partnership or partners is beyond the scope of this paper. Recommendations for further research will therefore include to what extent the income of a cross-border partnership should be attributed to that PE should it be found that a PE has indeed been created.

⁴³ See, for instance, the OECD Partnership Report.

2. Types of partnerships under South African domestic law

2.1 Introduction

The primary source of partnership law in South Africa is the common law, which is based on Roman and Roman-Dutch law (Bamford, 1982:x1vii).⁴⁴ The writings of the French jurist, Pothier, influenced the Roman-Dutch law of partnership to some extent and the South African courts have in the past viewed Pothier as an invaluable source of partnership law (Henning, 2014:7), notably in accepting Pothier's four *essentialia* of a partnership into South African law in *Joubert v Tarry*.

The South African law of partnership therefore inherited a number of different ways to classify partnerships from Roman and Roman-Dutch law. Partnerships can generally be grouped into universal *versus* particular partnerships on the one hand and ordinary *versus* extraordinary partnerships on the other hand (Davis et al., 2011:326).⁴⁵

2.2 Universal *versus* particular partnerships

Partnerships may be classified as either universal or particular. Pothier dates the classification of partnerships as universal *versus* particular back to Roman law (1854:23).

It is impractical to formulate a precise definition of the concept of a universal partnership. These types of partnerships would typically be entered into for an indefinite period of time and extend beyond a specified project (Davis et al., 2011:326). According to Pothier, Roman law recognised two different types of universal partnerships, *viz* the *societas universorum bonorum*⁴⁶ and the *societas universorum quae ex quaestu veniunt* (1854:23-24). Despite earlier views to the contrary,⁴⁷ both of these kinds of universal partnerships have survived in South African partnership law, as was recently accepted by the SCA in *Butters v Mncora*.

Pothier describes a *universorum bonorum* as a universal partnership of all property, "both present and future" (1854:24). In *Butters v Mncora*, the SCA held in a three over two majority that a tacit universal partnership (specifically the *universorum bonorum*) was created between two unmarried cohabitants, which

⁴⁴ Although specific aspects of partnerships are governed by legislation, for example in the areas of insolvency and criminal proceedings (Bamford 1982:x1vii) and the law of civil procedure in which special rules have been developed for partnerships that are involved in legal proceedings (Henning, 2014:156-163).

⁴⁵ Although Roman-Dutch law and ultimately South African law acknowledged other types of partnerships (Henning, 2006:para. 256), the classifications of universal *versus* particular and ordinary *versus* extraordinary seem to be more commercially relevant today than any other form of classification.

⁴⁶ Also referred to as the *societas omnium bonorum* (Henning, 2006:para. 257 fn. 2).

⁴⁷ De Wet and Yeats discarded the *universorum bonorum* as a concept only relevant in Roman law, having fallen into misuse in early Roman-Dutch law (1964:563). Bamford, relying on the writings of Grotius and Voet, indicated that a "universal partnership properly so called" (in referring to the *universorum bonorum*) may, save for certain exceptions, in general be unlawful and therefore invalid (1982:19).

partnership extended beyond a commercial undertaking. In this case, the plaintiff had shared in the benefits of the defendant's financial contribution to their common household whereas the defendant had shared in the benefits of the plaintiff's contribution to the maintenance of their common home and the raising of the children (although the plaintiff herself made a minor financial contribution to the common household). Heher JA, writing for the minority, disagreed with Brand JA's conclusion for the majority that a universal partnership had been created based on what Heher JA referred to at 18 para. 44 as "skimpy" evidence. The full bench, however, unanimously agreed with Brand JA's interpretation of the law relating to universal partnerships. Notably, Brand JA declined to recognise any special requirements for the existence of a universal partnership between cohabitees,⁴⁸ holding at para. 17 that universal partnerships between cohabitees, like all partnerships - universal or otherwise, are subject to the general *essentialia* of a partnership as formulated by Pothier and accepted into South African partnership law.

Unlike a universal partnership of all property, the *universorum quae ex quaestu veniunt* is a universal partnership only in respect of profits made in the pursuit of all forms of commerce or trade (Pothier, 1854:32). The *universorum quae ex quaestu veniunt* is also referred to as a partnership of general profits (De Wet & Yeats, 1964:563). As the *universorum quae ex quaestu veniunt* only relates to profits, this form of a partnership therefore excludes, for example, any donations or inheritances (Henning, 2006:para. 257). In *Isaacs v Isaacs*, 1949 (2) All SA 147 (C), the court acknowledged the following description formulated by Pothier of a universal partnership of general profits:

"The parties thereby contract a partnership of all that they may acquire during its continuance, from every kind of commerce. They are considered to enter into this kind of partnership when they declare that they contract together a partnership without any further explanation." (1854:32-33)

Particular partnerships, as opposed to universal partnerships, are usually restricted in terms of duration and subject matter (Davis et al., 2011:326). The different types of particular partnerships identified by Pothier include a partnership in relation to specified property, a partnership to exercise a certain art or profession together and a partnership in commerce or trade (1854:23). In this last category of particular partnerships concluded for purposes of commerce, a second method of classification, *viz* ordinary *versus* extraordinary partnerships, is particularly relevant.

⁴⁸ The SCA at para. 15 relied on the treatise of Felicius-Boxelius in recognising that a universal partnership of all property between cohabitees may be entered into tacitly, but rejected at para. 16 any special requirements for such a partnership as proposed by Felicius-Boxelius (*viz* cohabitation, sharing of profits and freedom of accounting to each other). As advocated by Henning, the impact of the writings of Felicius-Boxelius on Roman-Dutch and ultimately South African partnership law should not be underestimated (2014:9-14). The South African courts have, however, tended to base their decisions regarding partnership issues on Pothier's writings above all others (Olivier & Honiball, 2011:167).

2.3 Ordinary *versus* extraordinary partnerships

Partnerships and their partners may furthermore be classified as either ordinary or extraordinary. Ordinary partners are usually subject to the normal consequences of a partnership agreement,⁴⁹ whereas extraordinary partners are usually not treated as partners in the full sense of the word.

According to Pothier, ordinary partners are jointly and severally bound to all creditors for all debts that were incurred in the name of the partnership by a person who had the authority to contract on behalf of all of the partners (1854:71). This flows from the ordinary consequences of a partnership that partners manage the business of the partnership for each other as agents (Pothier, 1854:71).

In common law jurisdictions, partners incur primary liability in respect of all partnerships debts, which include the contractual and delictual debts of the partnership (Avery Jones et al., 2002:303). This accords with the position under South African law that ordinary partners can each be held liable for the full amount of all partnership debts (Henning, 2014:92).⁵⁰ In *Bester v Van Niekerk*, the AD noted at 783 as follows:

"[O]n dissolution, the enforceable liability of partners is joint and several in the absence of a contrary express or implied agreement with the creditor".⁵¹

Extraordinary partners, as opposed to ordinary partners, enjoy a certain measure of protection from liability. De Wet and Yeats describe the common feature of all extraordinary partnerships as having one or more partners that are only liable as partners to their co-partners and not to the outside world (1964:584). Since extraordinary partners are not jointly and severally liable to the outside world with their ordinary co-partners, such limited partners should not hold themselves out as ordinary partners to third parties (De Wet & Yeats, 1964:584-585). Where limited partners hold themselves out as ordinary partners, third parties acting in good faith may hold them liable as if they were ordinary partners (De Wet & Yeats, 1964:585-586).⁵²

Pothier identified two kinds of extraordinary partnerships, *viz* anonymous partnerships and partnerships *en commandite*, which should be distinguished from ordinary partnerships (1854:70). These two kinds of

⁴⁹ Ordinary partners would normally obtain the following general rights: to share in common profits, to manage the business of the partnership and in respect thereof represent the co-partners, to be compensated for incurring partnership expenses and to share in assets on dissolution; while ordinary partners would normally incur the following general obligations: to make a contribution to the partnership, to share in common losses, to manage the common interests as if it were their own and to account to their co-partners on all profits and benefits acquired in the course of carrying on the partnership (De Wet & Yeats, 1964:564-570). Note that this should not be seen as an exhaustive list and partners may, subject to certain minimum requirements, decide to vary the details of their particular partnership agreement.

⁵⁰ During the existence of the partnership, creditors of the partnership are required to enforce their claims against the partnership assets that are held by the partners in common, which should be distinguished from the private estates of the individual partners (De Wet & Yeats, 1964:572). It was held in *Lee v Maraisdrif (Edms) Bpk*, 1976 (2) SA 536 (A) at 58 that each partner in a partnership could be held liable for the full amount of all partnership debts upon dissolution of the partnership, notwithstanding that the liquidation of the partnership may not be finalised.

⁵¹ Quoted with approval in *Lee v Maraisdrif* at 58.

⁵² Even a third party, not being a partner in the partnership, may incur obligations that bind the partners in common if that third party had actual authority or alternatively ostensible authority to do so (De Wet & Yeats, 1964:574-575). See further chapter 3 below.

extraordinary partnerships are still recognised in South African common law today (Henning, 2014:92). A third kind of extraordinary partnership, known as special partnerships, was introduced by way of legislation in the Cape Province and Natal prior to South Africa becoming a Union (De Wet & Yeats, 1964:584). The important features of the three different kinds of extraordinary partnerships are described below.

2.3.1 Anonymous partnerships

Anonymous partnerships are partnerships in which the partners have agreed that the business of the partnership will not be carried on in the name of all of the partners (De Wet & Yeats, 1964:585). The known partner(s), in whose name the business is carried on, is in practice also referred to as the general partner, whereas the unknown partner(s) is referred to as the anonymous or silent partner(s). Although their names should not be disclosed to third parties, anonymous partners do not become liable as if they were ordinary partners simply because their names and involvement in the partnership have become known, provided they did not misrepresent themselves as ordinary partners (Henning, 2014:106-107).

An anonymous partner is not liable to third parties for partnership debts, provided he has not misrepresented himself as an ordinary partner to such third parties (De Wet & Yeats, 1964:585). Anonymous partners do, however, incur liability towards their co-partners in respect of their share of the partnership debts as agreed in terms of the partnership agreement (De Wet & Yeats, 1964:585). Unlike the partner *en commandite*, the liability of an anonymous partner is not limited to that partner's capital contribution to the partnership (Henning, 2014:106).

The court in *Sabatelli v St. Andrews Building Society*, 1933 WLD 55 confirmed at 57 that, for the duration of the partnership, an anonymous partner may not interfere or participate in the business or affairs of the partnership. This indicates another significant deviation from one of the normal consequences of an ordinary partnership, that anonymous partners, unlike their ordinary co-partners, are in principle not allowed to manage the business of the partnership as agents.

2.3.2 Partnerships *en commandite*

A partnership *en commandite* is very similar to an anonymous partnership. In brief, a partnership *en commandite* will not be carried on in the name of the partner *en commandite*, who will also not be liable to third parties for partnership debts, provided he has not misrepresented himself as an ordinary partner of the partnership (Pothier, 1854:43). The distinguishing feature between these two kinds of extraordinary partnerships is that, whereas anonymous partners incur open-ended liability towards their co-partners albeit limited to their agreed share of the partnership debts, partners *en commandite* may only be held liable by their co-partners up to a maximum of the amount that they contributed to the partnership (Pothier, 1854:43).

That the partnership *en commandite* is similar to an anonymous partnership, apart from the so-called liability cap as a distinguishing feature, was confirmed in *Eaton & Louw v Arcade Properties (Pty) Ltd*, 1961 (4) All SA 182 (T). Partners *en commandite* are likewise not allowed to manage the business of the partnership (Henning, 2014:99). The view has been expressed that partners *en commandite* should be able to manage the business of the partnership insofar as it relates to their capital contribution, however, this issue has not yet been settled in a South African court (Henning, 2014:100).

2.3.3 Special partnerships in the Cape Province and Natal

Special or limited partnerships were introduced by way of legislation⁵³ in the Cape Province and Natal prior to South Africa becoming a Union. Although the legislation that introduced special partnerships has since been repealed by the Pre-Union Statute Law Revision Act, 36 of 1976, any rights or obligations that may have accrued in terms of these statutes remain unaffected (Davis et al., 2011:328).

As a validity requirement, special partnerships had to be registered with the Registrar of Deeds (De Wet & Yeats, 1964:585). Henning notes that special partnerships are similar to the common law partnership *en commandite* (2015:251).⁵⁴ Special partners are therefore only liable towards their co-partners and their liability is limited to the amount contributed to the partnership. Special partners, like their common law equivalents, were not allowed to hold themselves out as partners to third parties and their names could not appear in the name of the partnership or business, failing which they could lose their protection from liability towards third parties in respect of partnership debts (De Wet & Yeats, 1964:585). Only the general partners could act on behalf of the special partnership (Henning, 2015:270). Save for advising the general partners, special partners were not allowed to partake in the management or business of the partnership (Henning, 2014:109).

2.4 The “foreign partnership” as a South African fiscal term

A “foreign partnership” as defined in s 1 of the Act is not a distinct kind of partnership in the same sense as the types of partnerships that have developed in the South African common law as discussed in 2.2 and 2.3 above. Rather it is a South African fiscal term that was introduced into the Act by way of the Taxation Laws Amendment Act, 7 of 2010 (hereafter referred to as the “2010 TLAA”), specifically to assist in classifying bodies of persons that were formed outside South Africa that contain some of the same characteristics as a partnership as understood under South African domestic law.

⁵³ The Cape Special Partnerships Limited Liability Act, 24 of 1861 and the Natal Special Partnerships Limited Liability Act, 1864.

⁵⁴ The availability of the (similar but less formalistic) common law partnership *en commandite* to investors is likely the main reason why the special partnership was never well received as a separate type of partnership in South Africa (Henning, 2015:274).

The definition of a “foreign partnership” was introduced primarily to align the South African tax treatment of partnerships that were formed outside South Africa and might otherwise have constituted hybrid entities, with the tax treatment of the country of formation (Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010:86).

In short, any partnership, association, body of persons or entity that was formed or established under the laws of any country other than South Africa will be regarded as a “foreign partnership” if that foreign body is treated as tax transparent in its country of formation (Olivier & Honiball, 2011:172). For purposes of the definition of a “foreign partnership”, a foreign body will be regarded as tax transparent in its country of formation if the receipts and accruals of that foreign body are subject to income tax in the hands of each member when amounts are received by or accrue to the foreign body and the foreign body itself is not liable for or subject to income tax (other than municipal, local or comparable taxes).⁵⁵ Where the country of formation does not have any income tax laws, the foreign body will be regarded as tax transparent if all amounts that are received by or accrue to the foreign body or expenditure incurred by that foreign body are allocated concurrently with the receipt, accrual or incurral to the members in their relevant proportions.⁵⁶

A “foreign partnership” as defined in the Act is expressly excluded from the definitions of a “company” and a “person” in terms of s 1 of the Act. Foreign partnerships as defined are therefore not regarded as taxable entities or taxpayers in South Africa. The result is that a partnership which is treated as fiscally transparent under the laws of a foreign country where it was established will likewise be treated as fiscally transparent for purposes of the Act. A fiscally transparent foreign partnership will not attract tax at entity level in South Africa; rather the partners may potentially be subject to tax on their share of the partnership income if South Africa has jurisdiction to tax that income in the hands of those partners. On the other hand, if a foreign partnership is *not* treated as fiscally transparent in its country of formation, it should likewise *not* be treated as fiscally transparent for purposes of the Act (Davis Tax Committee [DTC], 2014:29-30).

A body of persons which is not treated as fiscally transparent in its country of formation does not constitute a “foreign partnership” as defined and will likely fall into the wide definition of a “company”, which includes at para. (b) “any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law”. It is trite that a “company” as defined is regarded as a “person”⁵⁷ in terms of the Act. A body of persons that qualifies as a “company” and

⁵⁵ In terms of para. (a) of the definition.

⁵⁶ In terms of para. (b) of the definition. Note that para. (a) will usually determine whether an entity should be regarded as a “foreign partnership” or not (in which case para. (b) becomes irrelevant) as very few countries do not have any laws levying taxes on income (De Koker & Williams, 2016:para. 11.12A).

⁵⁷ The definition of a “person” in s 1 of the Act does not expressly include companies. However, the definition of a person in the Act is phrased as *including* only four cases that may otherwise have been subject to uncertainty based on the ordinary meaning of the word “person” (notably, natural persons were also omitted from the specific inclusions). The Interpretation Act, 33 of 1957, which applies to the interpretation of any law unless the particular law provides otherwise, defines in s 2 thereof a “person” as *including*, amongst others, “any company incorporated or registered as such under any law” and “any body of persons corporate or unincorporated” in paras. (b) and (c) of that definition. All companies and bodies of persons, whether incorporated or unincorporated, therefore qualify

therefore a “person” in terms of the Act is regarded as a taxpayer and income of that body may potentially be subject to tax at entity level if South Africa has jurisdiction to tax that income in the hands of that body.⁵⁸

This alignment of the tax treatment in South Africa with the foreign jurisdiction of formation serves to reduce the incidences of hybrid entities in accordance with the stated purpose of the 2010 TLA. The insertion of a definition of a foreign partnership in the Act is also in line with the “closest internal law equivalent” approach mentioned by Avery Jones et al. (2002:289), while the definition focusses on the crucial attribute of fiscal transparency (or not) in determining whether a body of persons that was formed outside South Africa should be taxed as a partnership in South Africa (or not).

2.5 The impact of s 24H on limited partners

Section 24H(1) of the Act defines a “limited partner” as meaning “any member of a partnership *en commandite*, an anonymous partnership, any similar partnership or a foreign partnership, if such member’s liability towards a creditor of the partnership is limited to the amount which the member has contributed or undertaken to contribute to the partnership or is in any other way limited”. A limited partner as defined will therefore include any extraordinary partner that may be involved in the three kinds of extraordinary partnerships known in the South African law of partnership.⁵⁹ The definition of a limited partner will also extend to a partner in a foreign partnership (as defined in s 1) if the liability of that partner towards creditors of the foreign partnership is limited in any way.

Section 24H(3) of the Act prohibits limited partners from claiming deductions or allowances in respect of the trade or business of a partnership that in aggregate exceed the sum of the amount for which that partner may be held liable by creditors of the partnership⁶⁰ plus any income received by or accrued to that partner from the trade or business of the partnership. Allowances or deductions that have been disallowed in terms of s 24H(3) may be carried forward by the limited partners to the succeeding year of assessment in terms of s 24H(4), subject to the same limitation each year. As a result, limited partners are unable to carry forward assessed losses in relation to their partnership income (Olivier & Honiball, 2011:176).

as persons in terms of the Interpretation Act as well as the Act, unless that body qualifies as a “foreign partnership” as defined in the Act, in which case it is expressly excluded from the definitions of “company” and “person” in terms of the Act.

⁵⁸ Further complexities arise as to how distributions to members should be taxed, which fall beyond the scope of this paper.

⁵⁹ Extraordinary partnerships include anonymous partnerships and partnerships *en commandite* under the common law as well as special partnerships that were created by statute in the Cape Province and Natal.

⁶⁰ Based on the practical approach suggested by Meyerowitz (1996:16-30 §16.79) and as illustrated in the example by Clegg and Stretch (2016:para. 16.3.9), this amount will presumably be equal to a limited partner’s agreed share of the partnership debts in an anonymous partnership, alternatively a limited partner’s capital contribution to a partnership *en commandite* or a special partnership created by statute in the Cape Province or Natal. However, creditors of the partnership may usually not hold limited partners liable *at all*, since limited partners only incur liability towards their co-partners and not towards outside creditors (Henning, 2014:93). The wording of this provision is therefore problematic as it seems to be based on the misconception that creditors of the partnership can directly hold limited partners liable to some degree.

Section 24H(2) of the Act deems every partner who carries on trade or business in a partnership to be carrying on such trade or business of the partnership, *notwithstanding that such partner may be a limited partner*. This constitutes a significant deviation from the original position in the South African law of partnership that extraordinary partners are generally not allowed to interfere or participate in the business or affairs of the partnership. The use of the word “notwithstanding” in s 24H(2) has the effect of extending the application of the deeming provision to all partners, whether they are ordinary or limited partners. However, the deeming provision was introduced specifically to assist limited partners, who will often have difficulties showing that they are indeed carrying on the business or trade of the partnership:

“In view of the fact that a limited partner may not disclose to outsiders the fact that he is a partner, and may not take part in the running of the partnership business, there is at present some doubt whether such a partner can himself be said to be carrying on the business of the partnership. Subsection (2) has accordingly been introduced to make it clear that such a partner [referring to a limited partner] will be deemed to be carrying on the trade or business of the partnership.” (Explanatory Memorandum on the Income Tax Amendment Bill, 1988:22)

In *Grundlingh v CSARS*, 2009 ZAFSHC 99, 72 SATC 1, the Full Bench of the Free State High Court applied s 24H(2) of the Act in the context of a cross-border partnership. In this case the taxpayer was a South African resident who practiced as an attorney in a partnership formed in Lesotho. The partnership’s business activities were confined to Lesotho, where its fixed place of business and office were located. Relying on s 24H(2), the court held at 10 para. 10.8 that the taxpayer was deemed to carry on the business of the partnership and therefore that the taxpayer’s profit share derived from the partnership was deemed to have been generated by the taxpayer due to the fact that he was a partner in the partnership.

The judgment in *Grundlingh* was handed down before the introduction of the definition of a foreign partnership in the Act. Had *Grundlingh* been decided today, the partnership in question would have constituted a foreign partnership as defined since the partnership was treated as fiscally transparent in terms of the laws of Lesotho as well as South Africa. The deeming provision in s 24H(2) states that it applies to partnerships but is silent as to whether it applies to foreign partnerships. This omission is peculiar since both ss 24H(1) and 24H(5) were amended with the introduction of the term foreign partnership in 2010 to specifically extend the application of those provisions to foreign partnerships. The stated purpose of s 24H(2) is to deem limited partners to be carrying on the business of the partnership. It is therefore submitted that the deeming provision in s 24H(2) should at least apply to limited partners of a foreign partnership. There also appears to be no reason why the application of s 24H(2) cannot be extended to ordinary partners of a foreign partnership as the word “partnership” as used in the provision has not been limited in any way. It is preferable that it be expressly clarified in s 24H(2) whether it should apply to partners of a foreign partnership.

The deeming provision contained in s 24H(2) is undoubtedly an important provision in determining the South African domestic tax consequences for limited partners in domestic and possibly foreign

partnerships. It is, however, questionable whether this domestic provision may be relied on at all for purposes of interpreting the provisions of a DTA to determine whether a PE has been created (Olivier & Honiball, 2011:188), as will be further explored in chapter 5 below.

2.6 Conclusion

This chapter 2 identified the major distinctions that may be drawn between different kinds of partnership in terms of current South African law. The great weight afforded by the South African courts to the writings of Pothier was once again illustrated when the SCA declined to recognise any special requirements for the existence of a universal partnership of cohabitation, holding that Pothier's *essentialia* should remain the threshold for the creation of any kind of partnership in South Africa.

Traditionally a distinction will be drawn between universal *versus* particular partnerships on the one hand and ordinary *versus* extraordinary partnerships on the other hand. Universal partnerships can further be divided into universal partnerships of all property and universal partnerships of general profits. Universal partnerships should not be ignored as these kinds of partnerships still feature in the South African partnership law of today, however, usually in a family context such as cohabitation. In commercial undertakings and especially in cross-border situations, particular partnerships would likely be more prevalent than universal partnerships. Particular partnerships, specifically particular partnerships in commerce or trade, will likely be the preferred partnership category for use in cross-border commercial undertakings. Particular partnerships in commerce may further be classified as either ordinary or extraordinary partnerships, which is a crucial distinction in determining the consequences for the partnership and its partners.

The categories of extraordinary partnerships in South African partnership law include anonymous partnerships and partnerships *en commandite* under the common law as well as special partnerships that were created by a (now repealed) statute in the Cape Province and Natal. A common characteristic that distinguishes extraordinary partners from ordinary partners is that extraordinary partners do not incur liability towards outside creditors of the partnership for partnership debts as they only incur liability towards their co-partners. Whereas anonymous partners may be held liable by their co-partners up to their agreed share of the partnership debts, the liability of partners *en commandite* towards their co-partners is limited to their capital contribution. As a result, extraordinary partners are as a rule not allowed to hold themselves out as partners to the outside world and furthermore may not interfere in the business of the partnership.

The term "foreign partnership" was introduced into the Act to align the South African tax treatment of cross-border partnerships with the tax treatment in its country of formation. Partnerships, associations, bodies of persons or entities that were formed under the laws of a country other than South Africa are regarded as

foreign partnerships as defined if they are treated as tax transparent in their country of formation. The South African *fiscus* will not seek to impose taxes on a fiscally transparent foreign partnership at partnership level but may tax the partners on their respective shares of the partnership income, provided South Africa has jurisdiction to tax that income in the hands of those partners. Conversely, the South African *fiscus* may seek to impose taxes at entity level on a cross-border partnership that is not fiscally transparent in its country of formation, provided South Africa has jurisdiction to tax that income in the hands of that partnership.

The position of limited partners (including anonymous partners and partners *en commandite* whose liability towards creditors are limited in some way) has been altered for income tax purposes by s 24H of the Act, which applies to the taxation of partnerships and foreign partnerships as defined. The significant deviations from the original position under South African partnership law include that limited partners are prohibited from claiming deductions or allowances in excess of their exposure to creditors of the partnership plus their share of the partnership profits⁶¹ and furthermore that *all* partners are now deemed to be carrying on the business or trade of the partnership.⁶²

Whereas ordinary partners are generally allowed to manage the business of the partnership for each other, extraordinary partners are now also deemed to be carrying on the business of the partnership in terms of the Act. The next chapter will consider the power of representation amongst partners in more detail, with particular focus on the difference between ordinary and extraordinary partners in this regard.

⁶¹ In terms of s 24H(3).

⁶² In terms of s 24H(2).

3. Partners as agents of the partnership or each other

3.1 Introduction to the South African law of agency

Representation or agency plays an important role in any partnership. In the context of particular partnerships concluded for purposes of commerce, Pothier notes that ordinary partnerships are entered into for the purpose of carrying on a business “in the name of all the partners” (1854:39) and further:

“Therefore, all the dealings that each of the partners enters into for that commerce are signed, ‘such a person and company.’ He is considered to contract therein, as well in his own name as in the name of his co-partners, who are considered to contract and bind themselves jointly with him by his agency.” (1854:39-40)

The principles of the South African law of agency derive from Roman-Dutch law, in terms of which direct representation was eventually recognised in spite of the earlier Roman law rule against contracting by representation (De Wet & Van Wyk, 1992:95). In general, the law of agency applies where one person (the agent) performs a juristic act on behalf of another person (the principal) with the intention that the legal consequences of that act should attach to the principal and not the agent (De Wet & Van Wyk, 1992:96).⁶³

Where an agent concludes a bilateral juristic act on behalf of another person, such as entering into a contract with a third party, the agent and the third party must agree that the contract will only give rise to rights and obligations for the third party and the principal (not the agent) (De Wet & Van Wyk, 1992:96). In establishing whether consensus was reached between the contracting parties, regard must be had to the intention of the agent and not that of the principal (De Wet & Van Wyk, 1992:98). The third party must be aware that the agent is contracting on behalf of a principal (even if the name of the principal is initially kept secret), as the third party will be entering into a legal relationship with that principal (Van der Merwe et al., 2007:254). This speaks to intention as a key requirement of the law of contract. It can be said that the agent and the third party are the parties to the contract, although the principal and the third party become the parties to the legal relationship flowing from that contract (Van der Merwe et al., 2007:252).

Persons who enter into contracts as agents on behalf of others must have the proper authority or power of attorney to do so (De Wet & Van Wyk, 1992:110). Granting authority is a unilateral act which need not necessarily be formally accepted in terms of an agreement (Van der Merwe et al., 2007:256). Actual authority (as opposed to ostensible authority) is usually granted by way of a contract of mandate in terms of which one person agrees to carry out the instruction of another person, which may also include (either

⁶³ Also referred to as direct representation since the rights and obligations accrue to the principal in a direct manner (Van der Merwe et al., 2007:255). Representation in terms of the South African law of agency goes beyond simply being a messenger or translator for another, and is different to what has been termed “indirect representation” where persons act in their own names but for the benefit of another, as these situations do not involve a person performing an act on behalf of another person as a result of which rights and obligations directly accrue to that other person (De Wet & Van Wyk, 1992:97).

expressly or tacitly by implication) the authority to conclude such an act *on behalf of* the other person (Van der Merwe et al., 2007:253).

Where a person purportedly concludes a contract with a third party on behalf of a principal without the necessary authority to do so, no legal relationship is created between the principal and the third party (De Wet & Van Wyk, 1992:114). The principal may, however, ratify the juristic act after it has been concluded by accepting the acts of the agent, either expressly or tacitly via conduct (De Wet & Van Wyk, 1992:114). Where a contract is ratified within a reasonable time, the agent is regarded as having had the proper authority to contract on behalf of the principal from the beginning (Van der Merwe et al., 2007:257). A person may also be held liable for acts concluded by a purported agent who did not have actual authority if that person (the principal) is guilty of creating the reasonable impression that the purported agent had the necessary authority to act on behalf of the principal in accordance with estoppel by representation, also referred to as ostensible authority (Van der Merwe et al., 2007:256-257).⁶⁴

The principles of the law of agency should not be confused with the doctrine of the undisclosed principal.⁶⁵ This doctrine developed in English law, from where it was accepted into South African law (Van der Merwe et al., 2007:263).⁶⁶ It should therefore *not* be seen as a component or extension of the law of agency as the two disciplines developed separately and originated from different legal systems. The doctrine applies where a person (the agent) enters into an agreement in his own name with a third party but under the instruction of an undisclosed principal to whom the agent is required to cede all rights under the contract (Van der Merwe et al., 2007:263). The agent does not necessarily have the authority to contract on behalf of the undisclosed principal but must have acted on the instruction of the undisclosed principal (De Wet & Van Wyk, 1992:125). The relationship therefore resembles an indirect form of representation. Provided the agent acted in accordance with his mandate, either the undisclosed principal or the third party (once the third party becomes aware of such principal) may choose that the undisclosed principal instead of the agent should become the party to the legal relationship flowing from the contract (Van der Merwe et al., 2007:263-264). This results in the strange outcome that a person may be held liable in terms of a contract to which that person was not a party, despite not having granted the necessary authority (Van der Merwe et al., 2007:264). The undisclosed principal is treated as having taken cession of the rights even though no cession had actually taken place (De Wet & Van Wyk, 1992:126). The outcome of successfully relying on the doctrine of the undisclosed principal is in a sense the same as direct representation, in that the principal and the third party are in the end bound by the legal relationship flowing from the contract entered into by the so-called agent and the third party.

⁶⁴ The recent case of *Bester NO v Schmidt Bou Ontwikkelings CC* (2016) JOL 35314 (SCA) confirmed at 10 para. 17 that the doctrine of estoppel, as accepted from English law into the South African common law, means that "when a person (the representor) has by words or conduct made a representation to another (the representee) and the latter acted upon the representation to his or her detriment, the representor is estopped, that is precluded, from denying the truth of the representation".

⁶⁵ The two subjects are often confused, especially where direct representation occurs albeit on behalf of a principal whose identity has not been disclosed (De Wet & Van Wyk, 1992:125).

⁶⁶ De Wet and Van Wyk question whether the doctrine should have been accepted into South African law in the first place (1992:124).

The basic principles of representation in terms of the South African law of agency (including, for ease of reference, the doctrine of the undisclosed principal) have been set out above. The relevance of these principles to South African partnerships will be discussed below. The focus of this paper is on the considerations that a South African court should take into account when considering the taxation of a cross-border partnership and therefore the South African position is investigated. However, a South African court may be required in terms of the rules of private international law to apply a foreign law in determining whether a particular partner in a cross-border partnership may in fact have acted with the necessary authority on behalf of the partnership or its partners.⁶⁷ It is submitted that the granting of authority to an agent is a relationship emanating from private law, in which case, as noted by Vogel, the rules of private international law remain relevant albeit in the context of taxation (1986:13).

There are significant differences between the law of agency in common and civil law jurisdictions, which impact on the application of the principles of agency to partnerships in those jurisdictions (Avery Jones et al., 2002:294).⁶⁸ As a general rule, common law jurisdictions only recognise *one* contract, whether such contract is brought about by an agent with the necessary authority acting on behalf of a principal or by the application of the doctrine of the undisclosed principal (Avery Jones et al., 2002:294), as is also the case under South African law.

3.2 Authorisation (including mutual mandate) amongst partners

It is generally accepted that the so-called “mutual mandate” between partners is a *naturalia*, ie a term which flows automatically from any partnership agreement (De Wet & Yeats, 1964:560).⁶⁹ Once a valid partnership agreement has been entered into which meets Pothier’s *essentialia*, the *naturalia* of a partnership agreement (including mutual mandate) will apply by implication. The *naturalia* of any contract may be varied expressly or tacitly by agreement between the parties (Van der Merwe et al., 2007:284). It follows that the mutual mandate amongst the partners may be varied by agreement *inter se*, although such variation would not bind *bona fide* third parties who are unaware of the arrangement (De Wet & Yeats, 1964:560).

In *Potchefstroom Dairies*, the Transvaal Provincial Division confirmed that the general principles of the law of agency apply to partners as a natural consequence of any partnership agreement, stating at 511 that:

“[P]artners are very often styled agents of each other. Whether they are actually agents or not (the law of agency as we understand it was developed much later than the law of partnership), they certainly have the

⁶⁷ In commercial contracts involving foreign elements, it is not uncommon for parties to include choice of jurisdiction and choice of law clauses whereby they agree which forum should adjudicate any dispute arising from the contract and in terms of which law. Parties choosing a South African court as the appropriate forum are likely to also choose South African law as the appropriate law.

⁶⁸ A comparative analysis of the law of agency goes beyond the scope of this paper.

⁶⁹ Van den Heever even elevated the mutual mandate to an additional *essentialia* for the conclusion of any partnership agreement, however, this view was rightly rejected by De Wet and Yeats in favour of it constituting a *naturalia* (1964:560).

powers of agents, and the broad principles of the law which are applicable to agents apply to this extent to partners.”

It is a requirement of the law of agency that agents may only act on behalf of principals that exist at the time that the agent acts (Van der Merwe et al., 2007:253). In the context of partnerships, which are not regarded as legal entities under South African law, the partnership itself cannot be regarded as a principal in a relationship of agency as the partnership does not exist in law.⁷⁰ In accordance with the aggregate approach, the partners themselves are the legal entities rather than the partnership. In considering the relevance of the law of agency in the context of partnerships, partners may therefore only be considered to act as representatives of *each other* but not of the partnership.⁷¹ In this sense, every partner may be regarded as a principal as well as an agent acting on behalf of the co-partners. In *Potchefstroom Dairies* it was confirmed at 511 that a partner “sustains the double character of agent and principal in one and the same transaction, and that not for a share only but in each capacity for the whole.”

Persons must be duly authorised before they may enter into agreements on behalf of others as their agents. Partners must likewise have the proper authority before they may conclude juristic acts that bind their co-partners (Henning, 2014:174).⁷² Partners may actively grant actual authority to any person (including one of the partners or a third party) to perform specified acts or even manage the general business operations of the partnership, which may expand the ordinary business of the partnership if such authority is granted expressly by all the partners (Henning, 2014:175). Acts concluded by a partner in the name of the partners in common without the necessary authority, should not give rise to legal obligations binding the co-partners but may also be ratified by the co-partners after the fact, whether expressly or tacitly via the conduct of the partners (Henning, 2014:175-176). These principles are in accordance with the principles of direct representation in terms of the law of agency.

Unique to the partnership as a business form is the mutual mandate that exists between the partners as a *naturalia* of any partnership agreement. This flows automatically from one of the ordinary consequences of a partnership that partners are usually allowed to manage the business of the partnership for each other as agents (Pothier, 1854:71). Mutual mandate in effect means that every partner has, by virtue of the partnership agreement, implied actual authority (as opposed to ostensible authority) to conclude contracts in the name of the partners in common (Henning, 2014:176). Partners need therefore not actively grant authority to one another for purposes of managing the business of the partnership (the extent of which is a

⁷⁰ It is regarded as a prerequisite that a partnership must have existed (or must have been held out to exist) before a partner is able to perform an act that binds the partners in common (Bamford, 1982:51). What is likely envisaged by this requirement is that the partnership agreement must have been validly concluded before a partner may, by virtue of the partnership agreement, start performing acts that bind the partners in common.

⁷¹ In common law jurisdictions, partners are usually regarded as agents of their co-partners (Avery Jones et al., 2002:296), as is also the case under South African law.

⁷² Henning, with respect, loosely refers to binding the *partnership* (2014:174-175) (as opposed to the co-partners), which is not possible under South African law as the partnership must exist as a legal entity before it may be bound as a principal to an agreement.

factual enquiry),⁷³ although the partners may by agreement amongst them vary the extent of the implied authority granted to the individual partners (Henning, 2014:176-177). A *bona fide* third party who is unaware of the variation will not be bound by the agreement amongst the partners *inter se* to vary the extent of a partner's implied authority, as long as the partner acted within the limits of the partnership business (Henning, 2014:179). The other partners may therefore be estopped from denying the misrepresentation created in the minds of *bona fide* third parties (*viz* that every partner has implied authority to manage the business of the partnership), without such third party having to prove the strict requirements of estoppel when dealing with a partnership (Henning, 2014:180). *Bona fide* third parties may also rely on the so-called *Turquand* rule⁷⁴ by assuming that a partner contracting on behalf of the partners in common had complied with all the internal requirements of the partnership agreement necessary to conclude such a contract (Henning, 2014:181).

Debts only bind the partners in common if the relevant partner who concluded the contract has, in addition to having had the necessary authority, concluded the contract *in the name of the partnership* (Pothier, 1854:71). Contracts that are not concluded in the name of the partnership but only in the name of the relevant partner do not bind the partners in common (Pothier, 1854:75) and cannot be ratified after the fact. This requirement speaks to the intention of the contracting parties. Regardless of the actual words used, the partners will be bound in common if it was the intention of the relevant partner and the third party that the contract should bind the partners in common, whereas the contract will only bind the relevant partner if it was the intention of that partner and the third party that it should not bind the partners in common (Henning, 2014:182-183).

Whereas the principles of the law of agency clearly find application in the partnership context, there is still some uncertainty as to whether the doctrine of the undisclosed principal should be extended to the partnership context (Henning, 2014:184). In *Eaton & Louw v Arcade Properties*, the Transvaal Provincial Division, with respect, erroneously viewed the doctrine of the undisclosed principal as an extension of the principles of the law of agency as applicable amongst partners.⁷⁵ A clear distinction should be drawn between direct representation and the doctrine of the undisclosed principal. While it is a crucial requirement of the law of agency (as derived from Roman-Dutch law) that the agent must have had the necessary (actual) authority to act on behalf of the principal, the doctrine of the undisclosed principal (as inherited from English law) does not require (actual) authority to have been granted.

⁷³ For examples of cases where partners have been held to have acted within the limits of mutual mandate and conversely where partners have been held to have exceeded their implied authority, see Henning (2014:177-178). This is purely a factual enquiry and is impacted by the particular business of the partnership.

⁷⁴ Named after the English case of *Royal British Bank v Turquand*, [1843-1860] All ER 435 that was accepted into South African law in order to protect *bona fide* third parties transacting with representatives of corporate entities. See, for example, *The Mine Workers' Union v Prinsloo*, (1948) 3 All SA 530 (A).

⁷⁵ At 190 the court remarked: "It seems to follow logically therefore that the law of agency in regard to acts by an agent on behalf of an undisclosed principal, namely that the undisclosed principal when discovered is liable to be sued on such a contract, is applicable where a partner acts on behalf of a partnership even though the existence of the partnership (and therefore of the other partners) is unknown to the party with whom he contracts in such circumstances."

3.3 Representation in the context of extraordinary partners

Extraordinary partners are often referred to as “passive investors” (Henning, 2015:252). This is indicative of the fact that one of the ordinary consequences of entering into a partnership does not apply to extraordinary partners as they are generally not allowed to interfere in the business of the partnership, as was confirmed by the court in *Sabatelli* at 57. Avery Jones et al. note that, both in common law and civil law jurisdictions (which often differ vastly on partnership law issues), limited partnerships usually afford limited liability to the limited partners provided the limited partners are not involved in the management of the partnership business (2002:292).

In *Eaton & Louw v Arcade Properties* the court held at 190 that (ordinary) partners in extraordinary partnerships do not have actual authority to bind the extraordinary partners. There is also no question of ostensible authority or estoppel provided the extraordinary partners have not held themselves out as partners. The court again seemed to extend the principles of the law of agency to the doctrine of the undisclosed principal in holding at 190 that this doctrine should not apply for purposes of binding an extraordinary partner as a so-called undisclosed principal.

Absent misrepresentation on their part, extraordinary partners are therefore not regarded as the agents of their co-partners. Furthermore, although partners usually have implied authority to contract on behalf of their co-partners in running the business of the partnership, such implied authority does not extend to contracting on behalf of extraordinary partners whose names and involvement in the partnership business must generally be kept secret.

3.4 Conclusion

South African law regards ordinary partners as each other’s agents in relation to the management of the partnership business. The unique legal nature of a partnership has the result that, in the same transaction, a partner may be regarded as an agent acting on behalf of the co-partners and a principal in own right.

The principles of the law of agency are often transplanted to the partnership context. An understanding of the basic rules contained in the law of agency is required to understand how partners may enter into contracts on behalf of their co-partners. It follows from the law of agency that an individual partner contracting on behalf of the partners in common must be duly authorised to do so and must furthermore contract in the name of the partnership. This is an application of direct representation, as the rights and duties directly bind the partners in common (as opposed to only the individual partner who concluded the contract).

Actual authority may be granted expressly or tacitly, whether to a partner or any other person. Authority may also arise *ex lege* by implication. Unique in the partnership context is the mutual mandate which arises automatically by virtue of any partnership agreement. Unless otherwise agreed, every ordinary partner has the implied authority to conclude acts falling within the ambit of the particular business of the partnership. The implied authority may be varied by agreement amongst the partners *inter se*, although such variation will not bind *bona fide* third parties who are unaware of the arrangement.

A distinction should be drawn between actual and ostensible authority. Ostensible authority is not granted as such. A principal (including the partners in common) may be held liable on the basis of ostensible authority in that the principal is estopped from denying the misrepresentation that was created towards *bona fide* third parties. The doctrine of estoppel does not operate on the basis of authority but rather holds a principal to the misrepresentation of authority.

Estoppel by representation or ostensible authority should furthermore be distinguished from ratification. Ratification can be done expressly or by implication. If an action is ratified, it appears that authority is almost granted retrospectively based on the principal's acceptance of the act. The outcome of ratification and estoppel by representation may be similar in that the principal becomes bound to the contract after conclusion, however, a ratified contract is treated as having been authorised from the beginning whereas estoppel simply provides a defence for *bona fide* third parties in certain circumstances notwithstanding that authority was never granted.

It has been said that the doctrine of the undisclosed principal may apply to partnerships albeit not in relation to extraordinary partners. Where an individual partner had not contracted in the name of the partners in common but under their instruction, either the partners in common or the third party may elect that the undisclosed principal should become bound to the legal relationship flowing from that contract. This doctrine developed separately from the law of agency. An important distinction between the doctrine of the undisclosed principal and direct representation in terms of the law of agency is that a so-called agent acting on the instruction of an undisclosed principal will not contract in the name of the undisclosed principal and need therefore not necessarily have had the authority to do so, whereas direct representation presupposes authority to act in the name of the principal. The doctrine of the undisclosed principal is often confused with the ordinary principles of direct representation as the outcome of applying the two disciplines may be similar in that the principal is bound by the legal relationship flowing from *one* contract concluded by the agent.

The position of extraordinary partners is very different to that of ordinary partners, unless the extraordinary partners have held themselves out to be ordinary partners (thus resulting in an application of ostensible authority). When ordinary partners act on the strength of mutual mandate, their actions do not bind extraordinary partners who are, as a rule, not liable to outside creditors. Furthermore, extraordinary partners

are not allowed to manage the business of the partnership and their actions are therefore not covered by the usual implied authority of ordinary partners. There is also support for the view that the doctrine of the undisclosed principal should not be extended to extraordinary partners although, with respect, this seems to have been on the misapprehension that this doctrine is an extension of the principles of representation in terms of the law of agency.

It is clear that ordinary partners may bind the partners in common by performing acts relating to the partnership, even in the absence of express authority being granted to such partners. In the next chapter, the focus will shift to the relevance of the place where partners perform their duties in the taxation of cross-border partnerships.

4. Sources of partnership income

4.1 Source as a means of establishing jurisdiction to tax

Countries impose taxes in accordance with their domestic tax rules, which flows from the fact that most countries have national sovereignty (Olivier & Honiball, 2011:1). However, a particular country may only levy taxes if it has the requisite “jurisdiction to tax”, which requires an appropriate link between the state concerned and the income which it seeks to tax (Olivier & Honiball, 2011:11). Importantly, this link⁷⁶ is determined under the domestic law of the state concerned. South Africa levies taxes on income based on the tax residence of the taxpayer or the source of the income.⁷⁷ It should therefore be considered whether South Africa has jurisdiction to tax based on the domestic concepts of tax residence or source of income for purposes of establishing the necessary link with South Africa, before relief from double taxation can be sought in terms of any applicable DTA.

For domestic law purposes, the term “resident” is defined in s 1 of the Act as including natural persons who are ordinarily resident in South Africa or physically present in South Africa for prescribed periods of time, or persons other than natural persons which are incorporated, established or formed in South Africa or which have their place of effective management in South Africa, excluding natural or non-natural persons who are deemed to be exclusively a resident of another country in terms of any DTA entered into between South Africa and that other country.⁷⁸ South Africa imposes taxes on all the income received by or accrued to its residents on a worldwide basis, while persons who are not South African residents for tax purposes are required to pay taxes in South Africa on all income received by or accrued to them from a source in South Africa.⁷⁹

South African domestic partnerships and “foreign partnership[s]” as defined are not subject to income tax in South Africa at entity level. As a result, South Africa may tax the income of the partnership in the hands of the partners on a flow-through basis, provided South Africa has jurisdiction to tax based on the residence of the partners or the source of the income in the hands of those partners (Olivier & Honiball, 2011:168). Section 24H(5)(a) of the Act, which also expressly applies to “foreign partnership[s]” as defined, deems the relevant share of the partnership income to have been received by or accrued to each partner *on the date*

⁷⁶ Referred to as the required “connecting factor” or “*nexus*” by Olivier and Honiball (2011:9). This terminology is also used in the international tax arena by Vogel and Rust, who explain that a “connecting factor” (either an attribute of the person being taxed, such as residency, or an attribute of the transaction, such as location of property) is needed with the state seeking to impose taxes before the provisions of the relevant DTA may be invoked (Vogel & Rust, 2015:31). DTAs do not introduce the right to tax but may in certain circumstances limit a country’s ability to impose taxes (Vogel & Rust, 2015:28-29). It is therefore premature to consult the provisions of a particular DTA before first considering whether the particular country has jurisdiction to tax the income under consideration.

⁷⁷ A few countries still impose taxes on the basis of citizenship or domicile (Olivier & Honiball, 2011:46-48). Habitual abode or *situs* of assets may also give rise to the imposition of taxes (Vogel, 1986:7).

⁷⁸ So-called “tie-breaker” tests appear in art 4 of the OECD, UN and SADC MTCs, which are used to determine the exclusive residence of a person that may be regarded as a resident of both Contracting States in terms of a particular DTA.

⁷⁹ In terms of the definition of “gross income” in s 1 of the Act.

which such income was received by or accrued to the partners in common. The partnership profits, together with any other income received by or accrued to the individual partners, will therefore be taxed in their hands while taking account of the partners' individual attributes for purposes of taxation.⁸⁰

Where the individual partners are not South African residents for income tax purposes but have a presence or are involved in activities in South Africa, South Africa will need to demonstrate source jurisdiction in order to impose taxes on the partnership income *in the hands of those partners*. It is submitted that, in the absence of residence or source jurisdiction under South African domestic rules, South Africa cannot without more rely on the provisions of a DTA to impose taxes by, for instance, claiming the existence of a PE in terms of that DTA. In the absence of jurisdiction to tax, the existence or otherwise of a PE in terms of a DTA should therefore be irrelevant from the perspective of a state seeking to impose taxes.

The source of income is a domestic law concept (Olivier & Honiball, 2011:10). Source rules will therefore invariably differ between countries. There is no definition of source in the Act. In the seminal case of *CIR V Lever Brothers & Unilever Ltd*, 1946 AD 441, 14 SATC 1, Watermeyer CJ held at 8-9 as to the meaning of source:

“[T]he source of receipts, received as income, is [not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, the *quid pro quo* which he gives in return for which he receives them.”

At common law, the source of income is therefore determined by looking at the “originating cause” of that income and where that originating cause is located (Olivier & Honiball, 2011:12). The court in *Lever Bros* found support in the case of *Millin v CIR*, (1928) A.D. 207, 3 SATC 170, where the AD held at 174-175 that the source of royalties which a novelist received from her publishers in the United Kingdom was located in South Africa, as she had employed her “wits and labour” in South Africa in writing her novels. It follows that the source of income originating from services rendered is usually regarded as the place where those services are rendered (Olivier & Honiball, 2011:15).⁸¹

All partners are required to make a contribution to the partnership in terms of the *essentialia* of any partnership agreement. In what may currently be regarded as the leading authority on the subject of the source of partnership income, the AD in *CIR v Epstein*, 1954 (3) SA 689 (A), 19 SATC 221 determined the source of partnership income in the hands of an individual partner by focusing on the place where that partner performed his duties in terms of the partnership agreement. Following the judgment in *Epstein*, legislative provisions were introduced into the Act by way of ss 9 and 24H, which deal with the source of

⁸⁰ For example, income derived by partners which are companies or close corporations will be subject to tax at the corporate income tax rate applicable to companies whereas income derived by partners who are natural persons will be subject to tax at the rates and rebate(s) (depending on their age) applicable to natural persons.

⁸¹ See, for example, *CIR v Nell*, (1961) 3 All SA 526 (A).

income and persons carrying on trade in partnership respectively. The impact, if any, of these provisions on the common law rules of the source of partnership income will be considered below.

4.2 The source of partnership income

In *Epstein*, the AD considered the source of partnership income derived by a partner who was resident in South Africa, where he also performed his duties as a partner of a partnership, which partnership carried on business in Argentina.

The business of the partnership entailed selling asbestos to customers of the partnership in Argentina. Once the partnership had solicited an order for asbestos, Mr Epstein's contribution to the partnership consisted of procuring such asbestos from the producer in South Africa and arranging for the shipment of the asbestos directly to the customer in Argentina.⁸² Although the business of the partnership was the selling of asbestos in Argentina, Mr Epstein's activities in connection with the partnership were confined to South Africa.

Centlivres CJ, writing for the majority (Schreiner JA dissenting), relied on *Lever Bros* and *Millin* and held at 223 that the source of Mr Epstein's share of the partnership income was located where Mr Epstein himself carried on his business activities on behalf of the partnership. As Mr Epstein's activities were confined to South Africa, the source of his partnership income was held to be located in South Africa. The domestic rule on partnership income is therefore that the source of each partner's share of the partnership income is located where *that partner* carries on business activities on behalf of the partnership.⁸³ With respect, this fragmented approach seems to ignore the characteristics of the partnership as a business form. The profits of a partnership first accrue to the partners in common, before it is distributed to the different partners in accordance with their profit share in terms of the partnership agreement.⁸⁴ Moreover, the partners do not receive their share of the partnership profit by virtue of their own activities but rather by virtue of the business activities of the partnership as a whole, from which they derive their respective profit shares.

Schreiner JA, dissenting, emphasised that a partnership is a business and found at 234 that the source of the partner's income should be where the business profits of the partnership are realised.⁸⁵ On the facts Schreiner JA held at 237 that the business profits were realised where the goods were sold ie Argentina. Schreiner JA remarked at 234 that apportionment may be required in the appropriate circumstances.

⁸² See *Epstein* at 227-228 for details of the partnership agreement.

⁸³ Centlivres CJ made the *obiter* statement at 233 that the source of partnership income may be located in two different countries if two partners are carrying on their business activities relating to the partnership in two different countries.

⁸⁴ Section 24H(5)(a) now deems those two events to occur simultaneously.

⁸⁵ Schreiner JA stated at 234 that "[t]he transactions in both countries were the transactions of both partners and the income which each received originated in the same place, wherever that might be".

In *CIR v Black*, 1957 (3) SA 536(A), 21 SATC 226, Schreiner ACJ, then writing for the majority, held at 235 that the dominant source of the taxpayer's income (which he derived from carrying on the business of a stockbroker in partnership with two other persons) was located where his capital was employed, ie the London Stock Exchange. The court took into account that all of the activities of the partnership were carried on in the United Kingdom, except that the taxpayer gave final authorisation for all the transactions entered into from South Africa.⁸⁶ The finding by the court in *Black* that the source of the taxpayer's share of the partnership income was located in the United Kingdom (where his capital was employed) does not seem to accord with the rule laid down in *Epstein* (that the source of partnership income is located where the individual partner carries on the business activities of the partnership). Lip service was paid to the *Epstein* judgment by distinguishing it on the facts of the case. Importantly, the position as set out in *Epstein*, although subject to criticism, currently remains the legal position on the location of the source of partnership income under the South African common law.

4.3 The influence of legislation

The source rules as set out above derive from the South African common law and are subject to legislative override, if applicable. The common law rules surrounding the source of partnership income may potentially be impacted by s 9, which contains deemed source rules or s 24H, which deals with persons carrying on trade in partnership.

Section 9 of the Act is specifically aimed at determining the source of certain kinds of income. This provision deems certain items to arise from a South African source⁸⁷ and conversely deems certain other items to arise from a source outside South Africa.⁸⁸ It is important to note that a partnership or "foreign partnership", being fiscally transparent, are treated as conduits. As a result, any income flowing through the partnership to the partners retains its nature (Olivier & Honiball, 2011:186). Therefore, individual items of income (for example, dividends, interest, royalties and exchange differences) flowing through a partnership to its partners may very well be impacted by the deeming provisions contained in s 9. It should be noted that s 9 contains no deeming provisions in relation to the source of the business income of a partnership or income for services rendered, except where those services are rendered to government agencies. The common law rules regarding the source of these kinds of income therefore remain relevant.

It has not yet been settled in a South African court whether the introduction of s 24H has an impact on the rules relating to the source of partnership income as laid down in *Epstein*. The purpose of s 24H is twofold:

⁸⁶ The outcome in Binding Private Ruling (BPR) 222 issued by SARS on 18 February 2016 seems to be aligned with the reasoning in *Black* that income will be regarded as deriving from a foreign source if the business activities of a partnership are substantially carried on outside South Africa, despite the fact that a partner may be deriving a share of the partnership profit while living in South Africa. BPRs should be treated with caution as these rulings are based on SARS's interpretation of the law, are issued without reasons being given and are only binding between SARS and the taxpayer concerned on the specific conditions as set out in the particular BPR.

⁸⁷ In terms of s 9(2). For example, local dividends (s 9(2)(a)).

⁸⁸ In terms of s 9(4). For example, foreign dividends (s 9(4)(a)).

first, it limits the expenditure that “limited partner[s]” may deduct in the calculation of their taxable income⁸⁹ and second, it deems income accruing to the partnership to simultaneously accrue to the individual partners in accordance with their profit share⁹⁰ (Explanatory Memorandum on the Income Tax Amendment Bill, 1988:21).

The fact that s 24H(5)(a)⁹¹ deems income accruing to the partnership to simultaneously accrue to the individual partners may at first glance create the impression that the provision may have an impact on the source of partnership profits. However, the provision is merely aimed at the timing of accrual and was introduced to combat the postponement of tax by partners based on the common law rule that was laid down in *Sacks* (which was that partners only become entitled to partnership profits once accounts are rendered in accordance with the partnership agreement) (Olivier & Honiball, 2011:169-170).

Section 24H(2) deems every partner to be carrying on the business of the partnership. It has been suggested, albeit subtly, that s 24H(2) may somehow have an impact on the rules surrounding the source of partnership income as laid down in *Epstein* (De Koker & Williams, 2016:para. 11.1 fn 1). However, s 24H(2) is likewise not aimed at source. According to the Explanatory Memorandum, the provision was introduced to clarify that limited partners are entitled to deductions (1988:22), albeit limited in terms of s 24H(3). The question arises whether s 24H(2) can have the unintended consequence of affecting the rules relating to the source of partnership profits. This outcome would be significant on the basis that the provision should also apply to “foreign partnership[s]”, although not expressly stated in the provision. The outcome of applying s 24H(2) to partners is that they are deemed to carry on the business of the partnership. It does not prescribe *where* the partners are deemed to carry on the business of the partnership, which leaves those partners to be deemed to carry on the business of the partnership wherever they may be.⁹² If the provision was aimed at deeming the source of partnership income to be South Africa, the words “in South Africa” could easily have been added to the end of the provision, which the legislature notably did not do.

There is no indication in s 24H of the Act nor in the 1988 Explanatory Memorandum that s 24H was intended to change the rules surrounding the source of partnership income as developed under the common law. In the absence of legislative override, the principles laid down in *Epstein* remain the leading authority on the source of partnership income. If there was ever an intention to vary the common law source rules, one

⁸⁹ In terms of s 24H(3).

⁹⁰ In terms of s 24H(5).

⁹¹ Which also expressly applies to “foreign partnership[s]” as defined.

⁹² The outcome in BPR 222 seems to suggest that SARS will not apply s 24H(2) as a source provision. The applicant in BPR 222 was a German resident who would become a South African resident while remaining a 100% limited partner of a limited liability foreign partnership, which in turn was a 100% limited partner of two further limited liability foreign partnerships which each carried on business through a PE in Germany. SARS ruled that the applicant would be entitled to a s 6quat rebate (credit) against foreign taxes paid by the three foreign partnerships, thus presupposing foreign sourced income in the hands of the applicant as required in terms of s 6quat(1A). Presumably SARS reached the conclusion that the applicant’s share of the partnership income would derive from a foreign source due to the partnership business activities substantially being confined to Germany (see, in this regard, *Black*), despite the applicant partner moving to South Africa (where s 24H(2) would deem him to be carrying on the business of the partnership).

would expect to see an insertion in s 9 of the Act relating to the source of partnership income, which specifically deals with the source of particular items of income.

4.4 Conclusion

South Africa levies taxes on income based on the tax residence of the taxpayer or the source of the income. Tax residence or source is therefore a means of establishing jurisdiction to tax, which is a prerequisite before South Africa may proceed to impose taxes. Persons who are South African resident for income tax purposes may be taxed in South Africa on their worldwide income, whereas persons who are not South African resident are only taxed on income derived from a source in South Africa.

Source rules have developed in terms of the common law. The majority decision in *Epstein*, although subject to criticism, remains the leading authority on the source of partnership income. Insofar as the business income of a partnership is concerned, the source of a partner's income will be located where the particular partner carries on the business activities of the partnership. The dissenting view is that the source of a partner's income should be located where the business profits of the partnership are realised.

Section 24H of the Act was not intended to alter the common law rules relating to the source of partnership income. It is submitted that this provision furthermore does not have the effect, whether intended or unintended, of altering the common law position relating to source. Section 9, on the other hand, is specifically aimed at deeming the source of certain items of income to be located in South Africa or outside South Africa in certain circumstances. Indeed, should items of income listed in s 9 (eg dividends, interest, royalties and exchange differences) accrue to a partnership, such income would retain its nature while flowing through to the hands of the partners and the deeming source provisions contained in s 9 may very well apply to those specific items. There are no deeming provisions relating to the source of the business income accruing to a partnership and accordingly the common law rules laid down in *Esptein* should still apply.

Where South African source income is present, this will not necessarily lead to the existence of a PE in South Africa as these two concepts are based on very different rules. However, the source of income may serve as the necessary connecting factor and will especially be important in the context where non-resident partners have a presence or are involved in activities in South Africa. In this scenario, South Africa should, in the absence of South African source income, not have the requisite jurisdiction to impose taxes on those non-resident partners and there will furthermore be no basis for the application of the terms of a DTA in terms of which a PE may have been found to exist.

5. Permanent establishments

5.1 Introduction to the application of DTAs to partnerships⁹³

The term PE is comprehensively defined in art 5 of the MTCs published by the OECD, UN and SADC respectively.⁹⁴ The existence of a PE in terms of a DTA usually allows the Contracting State⁹⁵ in which the PE is located to exercise its domestic taxing rights in respect of the profits that are attributable to the PE of a non-resident enterprise (OECD Commentary, 2014:C(5)-1 para. 1). A PE, if found to exist, may therefore have a significant impact on the taxation of a cross-border partnership.

The existence of a PE in terms of a DTA presupposes that the particular DTA applies to the circumstances at hand. DTAs generally only apply to *persons* who are regarded as *residents* of at least one of the Contracting States that are a party to the particular DTA.⁹⁶

The OECD MTC and the UN MTC defines a “person” as including an individual, a company *and any other body of persons*.⁹⁷ The OECD Commentary⁹⁸ on art 3 explains that the definition of a “person” should be widely construed so as to include all partnerships (2016:C(3)-1 para. 2). On the other hand, the SADC MTC defines a “person” as including an individual, a company *and any other body of persons that is treated as an entity for tax purposes*.⁹⁹ The SADC Commentary¹⁰⁰ on art 3 confirms that the reference to bodies of persons that are treated as entities for tax purposes are meant to limit the application of the SADC MTC to partnerships that are taxable at entity level (2011:5). Any particular DTA may of course be negotiated so as to expressly include or exclude fiscally transparent partnerships from the meaning of the term “person” as used in the DTA.¹⁰¹

If a partnership is regarded as a “person” in terms of a DTA and provided partnerships are not specifically excluded from the application of the DTA under consideration, the further question arises whether the partnership can be regarded as a resident. A “resident of a Contracting State” is described in art 4 of the OECD, UN and SADC MTCs as any person who is *liable to tax* under the domestic laws of that State by reason of domicile, residence, place of management or any other criterion of a similar nature but excludes persons who are liable to tax in that State solely in respect of income from sources in that State or capital situated therein.

⁹³ See, in general, the OECD Partnership Report.

⁹⁴ The UN and SADC MTCs are largely based on the OECD MTC and therefore these three MTCs follow the same structure.

⁹⁵ The term “Contracting State” is commonly used to describe any one of the states that have validly entered into a DTA.

⁹⁶ Article 4 of the OECD, UN and SADC MTCs.

⁹⁷ Article 3(1)(a).

⁹⁸ Commentaries on the Articles of the Model Tax Convention.

⁹⁹ Article 3(1)(k).

¹⁰⁰ Commentary on the Articles of the SADC Model Tax Agreement.

¹⁰¹ See Olivier and Honiball for examples involving South Africa (2011:185).

The meaning of the words “liable to tax” in terms of the DTA entered into between South Africa and Lesotho was interpreted by the High Court in *Grundlingh*. The court held at 10 para. 10.8 that the partnership in that case was not an enterprise liable to tax in Lesotho and therefore that the provisions of the DTA did not apply. Hattingh, although agreeing with the outcome of the case, criticises this statement by the court as the individual partner was indeed the enterprise liable to tax which led to the application of the DTA (2010:24, 28). The court in *Grundlingh* based its interpretation of the words “liable to tax” on whether the partnership was in principle liable to tax in terms of substantive income tax legislation and disregarded any related administrative practices such as, for example, joint returns (Hattingh 2010:27). South African domestic partnerships and “foreign partnership[s]” as defined in s 1 of the Act should therefore not be regarded as “resident[s]” in terms of DTAs based on the OECD and UN MTCs on the basis that partnerships and foreign partnerships are fiscally transparent and therefore in principle not liable to tax (Olivier & Honiball, 2011:185).¹⁰²

When interpreting a particular DTA, a South African court, although not bound by the relevant commentary, may have regard to the relevant commentary insofar as it assists the court in the interpretation and application of the provisions contained in the DTA.¹⁰³ Especially the OECD Commentary has proven very valuable in promoting a uniform interpretation of DTAs on an international level (Vogel & Rust, 2015:45).

The OECD Commentary on art 4 confirms that where a fiscally transparent partnership is excluded from the application of a DTA as a result of not being liable to tax, the partners themselves would be the persons who are liable to tax in respect of the partnership income. Therefore the individual partners should be allowed to claim the benefits of DTAs concluded by the States of which they are residents in relation to the partnership income accruing to them (2014: C(4)-4 para. 8.8).¹⁰⁴ This accords with the approach suggested in the UN Commentary¹⁰⁵ on art 1 that, in the absence of special provisions, the partners should be entitled to benefits of the DTA if the partnership is regarded as a mere conduit (2011:42 para. 5).

Once it is established whether a particular DTA applies to a partnership or the individual partners, the further question arises in which circumstances the presence or activities of a partner or partners in South Africa may give rise to the creation of a PE in relation to the business of a partnership.

¹⁰² Fiscally transparent partnerships would not even pass the first hurdle required for the application of DTAs that follow the wording of art 3(1)(k) of the SADC MTC as these partnerships would not be regarded as “person[s]” in terms of the DTA.

¹⁰³ See, in particular, *Downing*.

¹⁰⁴ This approach accords with the approach suggested in the UN Commentary (UN Commentaries on the Articles of the UN MTC) on art 1 (2011:42 para. 5) that, in the absence of special provisions, the partners should be entitled to the benefits of the UN MTC if the partnership is regarded as a mere conduit.

¹⁰⁵ UN Commentaries on the Articles of the UN MTC.

5.2 Brief overview of the PE concept¹⁰⁶

The term “permanent establishment” is defined in terms of section 1 of the Act to mean a PE as defined from time to time in art 5 of the OECD MTC.¹⁰⁷

There are two schools of thought on the interpretation of DTAs, namely the ambulatory and the static approach (Vogel & Rust, 2015:66-67). The ambulatory approach supports the interpretation of a DTA in accordance with the law at the relevant time when the DTA is to be relied on, whereas the static approach requires that the DTA be interpreted in line with the law as it stood when the DTA was concluded (Vogel & Rust, 2015:66). This issue has not yet been definitively settled in a South African court. However, the OECD MTC (full version) now specifically supports an ambulatory interpretation (2014:I-3 para. 9). Furthermore, the use of the words “from time to time” in the South African domestic definition of a PE suggests a preference for the ambulatory approach in the interpretation of the PE term, at least under South African domestic law.

“Above all, the PE concept serves as the key principle on the assignment of the right to tax business profits.” (Reimer, 2015:334)

The existence of a PE in terms of a DTA allows the country in which the PE is located¹⁰⁸ to exercise its taxing rights in respect of the business profits attributable to the PE of a non-resident enterprise, while the residence state of that enterprise is required to forego its taxing rights in respect of that income (Reimer, 2015:334).

The allocation of taxing rights in relation to business profits is dealt with in art 7 of the OECD, UN and SADC MTCs. Article 7(1) of these MTCs allocates taxing rights in relation to the business profits of an enterprise to the state of residence, *unless* the enterprise carries on business in the other state through a PE situated therein, in which case the other state may tax the business profits that are attributable to that PE.¹⁰⁹

The term “business profits” is not defined in the OECD, UN or SADC MTCs.¹¹⁰ All of these MTCs provide that items of income that are specifically dealt with in other provisions should not be affected by art 7

¹⁰⁶ An exhaustive analysis of the term PE is beyond the scope of this paper. Rather, the focus will be on the attributes of a partnership or foreign partnership that may have an impact on the PE enquiry.

¹⁰⁷ The South African domestic definition of a PE contains a carve-out for acts that relate to financial instruments in that when determining whether a “qualifying investor” (which contains similar features to those of a partner *en commandite*) in relation to a partnership, trust or foreign partnership has a PE in South Africa, any act of that partnership, trust or foreign partnership in respect of any financial instrument must not be ascribed to that “qualifying investor”.

¹⁰⁸ Referred to as the source state (Reimer, 2015:334).

¹⁰⁹ Article 7(1) of the UN MTC casts a wider net than its counterparts in the OECD MTC and SADC MTC by not only affording taxing rights to the other state in respect of the profits attributable to the PE, but also in respect of sales in the other state of goods or merchandise of the same or similar kind as those sold through the PE or other business activities carried on in the other state of the same or similar kind as those effected through the PE.

¹¹⁰ See, however, the wide meaning ascribed to “business” as discussed below.

governing business profits.¹¹¹ This is significant in the context of a fiscally transparent partnership as income flowing through such a partnership to the partners will retain its nature (Olivier & Honiball, 2011:186), for example as interest, which will then fall to be dealt with in terms of the specific interest provisions contained in art 11 of the particular DTA.

A PE can only exist in relation to an “enterprise”. Taxing rights are then only allowed to be exercised by the state in which the PE is located if the business of the enterprise is carried on through that PE. The meaning of the term “enterprise” is therefore of critical importance as there can be no PE without an enterprise. The meaning attributed to “enterprise” is very wide and means the carrying on of any business.¹¹²

The term “business” is generally understood in a wide sense as illustrated in the well-known statement by Jessel MR in *Smith v Anderson*, (1880) 15 ChD 247 at 258 that “anything which occupies the time and attention and labour of a man for the purpose of profit is business”. The OECD MTC¹¹³ and the SADC MTC¹¹⁴ define the term “business” as including the performance of professional services and other activities of an independent character while the UN MTC is silent on the meaning of the term. Where the MTC does not define a term, countries may defer to the meaning thereof under their domestic law, unless the context of the DTA requires otherwise.¹¹⁵

With the exception of certain universal partnerships, a partnership necessarily involves the carrying on of a business. A partnership itself is therefore capable of being regarded as the carrying on of an enterprise, regardless as to whether the partnership has legal personality or is liable to tax.¹¹⁶ It is submitted, however, that it should be irrelevant whether a PE of a partnership exists in a state wherein that partnership is not liable to tax at partnership level as that state would have no jurisdiction to tax a PE of an entity that is not susceptible to taxes at entity level. In the case of a fiscally transparent partnership, one looks to the partners themselves, who may each be regarded as having a PE that is liable to tax (OECD Partnership Report, R(15)-26 para. 81). Each partner of a fiscally transparent partnership may therefore be regarded as carrying on an enterprise in relation to which a PE may be found to exist, although this may not necessarily extend to extraordinary partners who often do not carry on the business activities of the partnership.

Olivier and Honiball note that, where a partnership does not constitute a “separate entity”, a partner cannot create a PE for the partnership itself (2011:187). Presumably this view is held because those jurisdictions would simply look through the partnership to the individual partners when imposing taxes. This view is

¹¹¹ In terms of art 7(4) of the OECD MTC, art 7(6) of the UN MTC and art 7(7) of the SADC MTC.

¹¹² In terms of art 3(1)(c) of the OECD MTC and art 3(1)(g) of the SADC MTC. Article 3(1)(c) of the UN MTC widens the term even further by describing an enterprise as something carried on by a resident of one of the Contracting States.

¹¹³ Article 3(1)(h).

¹¹⁴ Article 3(1)(d).

¹¹⁵ Article 3(2) of the OECD, UN and SADC MTCs.

¹¹⁶ See the OECD Partnership Report at R(15)-26 para. 81 in which reference is made to the enterprise carried on by a fiscally transparent partnership.

supported by the OECD Commentary on art 5 in the context of building sites or construction or installation projects lasting more than 12 months.¹¹⁷ Although the 12 month test is applied at partnership level (ie looking at the time spent collectively by all the partners and employees of the partnership at the site), if the time spent at the site by representatives of a fiscally transparent enterprise exceeds 12 months, *each* partner will be considered to have a PE for purposes of the taxation of their share of the business profits of the partnership (OECD Commentary, C(5)-12 para. 19.1).

Olivier and Honiball further note that an ordinary partner can give rise to the existence of a PE as ordinary partners generally carry on the business of the partnership (2011:188). On the other hand, an extraordinary partner may not always be regarded as carrying on the business of the partnership (which is a prerequisite of an enterprise), thus rendering it difficult for a PE to have been created (2011:188). In a South African domestic context, s 24H(2) of the Act deems every partner to be carrying on the business or trade of a partnership, notwithstanding that such partner may be a limited partner. Olivier and Honiball rightly question the application of such a domestic provision when interpreting international treaties¹¹⁸ and point out that it should be investigated on the facts of each case whether an extraordinary partner is indeed engaged in carrying on the business of the partnership (2011:188).

The wording of art 5 as it appears in the current versions of the OECD, UN and SADC MTCs are compared in table format in Annexure C hereto. In brief, the PE article contains a general definition as well as a few specific provisions which in some instances elaborate on the general definition of a PE and in other instances stand alone as separate tests as to whether or not a PE has been created.

The general definition of a PE is described in art 5(1) of the OECD, UN and SADC MTCs as a fixed place of business through which the business of an enterprise is wholly or partly carried on. All of the terms used in the general definition have been debated at length as will appear from the various Commentary. In determining whether the required degree of permanency has been maintained so as to constitute a *fixed* place of business, regard may be had to the activities of related persons (OECD Commentary, 2014: C(5)-6 para. 6.2), which will likely entail looking at the business activities of a partnership as a whole, which may be carried on by any one or more of the partners.¹¹⁹ Significant in the partnership context is that the general definition only recognises a PE if the business of an enterprise is at least partly carried on through that enterprise. Thus persons holding passive investments should not give rise to the creation of a PE (Reimer, 2015:338). On the basis that the domestic provisions contained in s 24H(2) should not apply in the interpretation of art 5(1), extraordinary partners should be less at risk of creating a PE on behalf of the partnership or co-partners than their ordinary counterparts. However, it remains a factual enquiry and

¹¹⁷ See art 5(3).

¹¹⁸ Although the court in *Grundlingh* relied on s 24H(2), this was *not* done in order to determine whether a PE had been created in terms of a DTA.

¹¹⁹ This is referred to as a "horizontal share of control", which may occur in the context of joint ventures and/or partnerships (Reimer, 2015:355).

extraordinary partners in name who in fact carry on the business of the partnership would not be considered to be passive investors.

Article 5(2) goes on to list examples of places that could constitute PEs provided such places meet the general requirements laid down in art 5(1) (OECD Commentary, 2014: C(5)-9 para. 12; UN Commentary, 2011: 105 para. 4; SADC Commentary, 2011: 7).¹²⁰

Article 5(3) is an alternative test for the creation of a PE that relates specifically to building sites or construction or installation projects and, in the case of the UN and SADC MTCs also extends to so-called services PEs. It is conceivable that partners may be rendering services in South Africa as their contribution to the partnership or otherwise, as will be more fully explored in 5.4 below.

Article 5(4) excludes activities that are purely of a preparatory or auxiliary character from creating a PE.

Article 5(5) determines that a PE will be created where a person is acting on behalf of an enterprise and has, and habitually exercises, an authority to conclude contracts in the name of the enterprise in respect of any activities which that person undertakes for the enterprise, unless the activities of that person are limited to activities of a preparatory or auxiliary character as listed in art 5(4). Article 5(5) relates to “dependant agents” (OECD Commentary, 2014: C(5)-18 para. 32). The test contained in art 5(5) is an alternative test to the general definition of a PE contained in art 5(1). Therefore, art 5(5) is not subject to the requirements of art 5(1) and a PE can be created by meeting the requirements of art 5(1) *or* art 5(5) (OECD Commentary, 2014: C(5)-19- C(5)-20 para. 35). Article 5(5) is of particular relevance to partnerships, especially in light of the implied mutual mandate amongst ordinary partners, as will be more fully explored in 5.3 below.

On the other hand, independent agents simply acting in the ordinary course of their business on behalf of an enterprise should not give rise to the creation of a PE for that enterprise due to art 5(6).¹²¹

5.3 Authority to conclude contracts in the name of an enterprise – art 5(5)

The fact that partners are generally regarded as agents of one another under the South African common law is of great importance in determining whether a PE has been created in terms of the alternative test as contained in art 5(5) of the OECD, UN and SADC MTCs.¹²² It should be noted that an enterprise need not

¹²⁰ See, however, a different view held by the Tax Court in ITC 13276 based on the use of the words “includes especially” in art 5(2)(k). Note that Tax Court decisions do not create binding legal precedent in South Africa.

¹²¹ Article 5(6) of the OECD and SADC MTCs as well as art 5(7) of the UN MTC.

¹²² Article 5(5) of the SADC MTC follows its equivalent in the OECD MTC to the letter (SADC Commentary, 2011: 9). The UN MTC contains a further alternative test for the creation of a PE in art 5(5)(b) thereof where a person who has no authority to conclude contracts in the name of an enterprise habitually maintains a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise.

have a fixed place of business in order for a PE to have been created in terms of art 5(5) as this test is not subject to the general requirements contained in art 5(1).

Article 5(5) deems a PE to have been created in a Contracting State if a person, who has the authority to conclude contracts in the name of an enterprise, habitually exercises such authority in that Contracting State. As the granting of authority is a relationship emanating from private law, the rules of private international law should be used to determine whether a person actually had the authority to conclude contracts in the name of the enterprise (Reimer, 2015:387). The fact that contracts have to be concluded in the name of the enterprise indicates that the dependent agent must have the necessary authority to achieve direct representation,¹²³ which authority must be habitually exercised. Whether authority has indeed been habitually exercised, is a factual enquiry which will depend largely on the business of the enterprise (OECD Commentary, 2014: C(5)-19 para. 33.1).

The term authority as used in art 5(5) seems to be meant in a technical legal sense. In order to determine whether an agent indeed had authority, regard must be had to the appropriate law governing the granting of authority between agent and principal. The reference to “authority” used in art 5(5) seems to imply actual authority, as opposed to ostensible authority (or estoppel by representation).¹²⁴

Estoppel by representation should be distinguished from ratification after the fact. If a principal ratifies a contract it is treated as having been properly authorised from the beginning, whereas estoppel by representation simply prevents a principal from denying the misrepresentation that was created. It is therefore submitted that an agent who habitually concludes contracts in the name of an enterprise without the necessary authority can give rise to a PE in terms of art 5(5), provided the enterprise ratifies such contracts retrospectively. Note that ratification can occur expressly or tacitly via conduct. On the other hand, ostensible authority or estoppel should not give rise to a PE by virtue of art 5(5) as there is no actual authority in such case.

It must be borne in mind that actual implied authority arises automatically by virtue of the conclusion of any partnership agreement under the South African common law. This implied authority or mutual mandate is recognised as actual authority amongst ordinary partners, albeit not expressly granted. The partners’ implied authority is limited to the business of the partnership. Art 5(5) also envisages the entering into of contracts that relate to the business of the enterprise (OECD Commentary, C(5)-18 para. 33). Ordinary partners that habitually conclude contracts in the name of the partnership (ie the partners in common) in

¹²³ The contract need not be in the exact name of the enterprise, provided the parties clearly intended that the enterprise be bound to the contract, as opposed to the agent (OECD Commentary, 2014: C(5)-18 para. 32.1). Direct representation in terms of the South African law of agency likewise does not require that the name of the principal actually be used, as long as the intention is clear.

¹²⁴ Support can be found for this view by the use of the term “actual authority” in the example portrayed in the OECD Commentary (2014: C(5)-18 para. 32.1).

accordance with their implied authority will therefore be at great risk of creating a PE for themselves and each one of their co-partners by virtue of art 5(5).

The successful application of the doctrine of the undisclosed principal should not fall within the ambit of art 5(5). Rather, a person acting for an undisclosed principal may very well be regarded as an independent agent in terms of art 5(6), which does not give rise to the creation of a PE without more. Although the outcome of applying the doctrine of the undisclosed principal may resemble direct representation in that the undisclosed principal, once disclosed, may eventually become bound to the legal relationship flowing from the contract, the agent would not conclude the contract in the name of the undisclosed principal and need therefore not have had the authority to do so. A situation that qualifies for the application of the doctrine of the undisclosed principal should therefore be disqualified from the application of art 5(5) and may possibly fall within the ambit of art 5(6).

Ordinary partners are therefore at great risk of creating a PE for themselves and their co-partners in terms of art 5(5). Extraordinary partners, on the other hand, should in theory be no more at risk of creating a PE for their co-partners in terms of art 5(5) than any third party unrelated to the partnership. Extraordinary partners are usually not allowed to interfere with the management of the partnership business and therefore the implied authority or mutual mandate does not extend to such partners. If, however, the partners in common granted actual authority, whether expressly or tacitly, to an extraordinary partner (or to any third party) to conclude contracts in the name of the partnership, art 5(5) may apply. Where an extraordinary partner or a third party was held out to be an ordinary partner, such person may potentially be held liable as an ordinary partner by *bona fide* third parties, however, actual authority cannot be said to have been granted and therefore art 5(5) should not apply.

Ordinary partners represent each other as agents of their partnership business when dealing with the outside world. However, partners usually do not represent their extraordinary co-partners whose identities and involvement in the partnership are meant to be kept secret. Therefore, ordinary partners that conclude contracts in the name of the partnership, although potentially creating a PE for their ordinary co-partners, should not be able to create a PE for their extraordinary partners by virtue of art 5(5).

5.4 Services PE – art 5(3)(b)

An additional test for the creation of a PE may become relevant in the partnership context where partners perform services in South Africa as their contribution to a cross-border partnership or otherwise where partners stay involved in the business of the partnership by the rendering of services.¹²⁵ This is referred to

¹²⁵ Extraordinary partners are not likely to render services to the partnership as their names and involvement in the partnership are meant to be kept secret.

as the so-called services PE, which can be found in art 5(3)(b) of the UN and SADC MTCs. The OECD MTC does not currently contain a services PE.

Article 5(3)(b) is a further alternative test for the creation of a PE which need not necessarily comply with the requirements of the general definition contained in art 5(1). A PE encompasses the furnishing of services, including consultancy services, by an enterprise *through employees or other personnel* engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.¹²⁶

The question arises whether partners may be considered as employees or other personnel as envisaged in art 5(3)(b) of the UN and SADC MTCs. It seems that where a partnership does not have legal personality in terms of the laws of its country of formation, the partners cannot be regarded as employees of the partnership (Olivier & Honiball, 2011:186-187). This seems to be implied in the OECD Commentary in the context of fiscally transparent partnerships having building sites or construction or installation projects lasting more than 12 months,¹²⁷ where reference is made to time spent on the site by the “partners and employees” (2014: C(5)-12 para. 19.1). The result is that the services PE contained in art 5(3)(b) of the UN and SADC MTCs in its current form should not apply to the activities of a partner of a partnership that is not regarded as a legal entity, as such a partner would not be regarded as an employee of the partnership. On the other hand, where a partnership is regarded as a legal entity in terms of the laws of the source country, the partners may be regarded as employees of the partnership, which may give rise to the application of art 5(3)(b).

If one has regard to, for instance, the variation of the services PE as contained in art 5(3)(b) of the DTA between South Africa and the United Kingdom,¹²⁸ it seems that the services PE can easily be extended to the activities of a partner, notwithstanding the legal personality of the partnership, by substituting the words “employees or other personnel” as contained in the UN MTC with the word “individual” as contained in that DTA.

In order to constitute a services PE, the relevant activities carried on in a Contracting State must be of the same nature and must relate to the same or a related project (Reimer, 2015:403-404).

¹²⁶ Article 5(3)(b) of the UN MTC. Article 5(3)(b) of the SADC MTC contains similar wording, although the 183-day time period is not stipulated and it is left to the Contracting States to negotiate the maximum time period.

¹²⁷ Article 5(3) of the OECD MTC.

¹²⁸ 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.

The South African Tax Court in ITC 13276 recently considered the creation of a PE by way of the rendering of services by employees of a foreign company in South Africa. In that case, the Tax Court was called upon to interpret the services PE clause in terms of the DTA between South Africa and the USA.¹²⁹ The services PE clause in that DTA follows the wording of art 5(3)(b) of the UN MTC, although inserted as art 5(2)(k), where one would ordinarily expect to see examples of what could constitute a PE if the requirements of the general definition contained in art 5(1) are met. With respect, the court erred at para. 39 by interpreting the words “includes especially” preceding the examples listed in art 5(2) as giving rise to a PE without having to meet the requirements of art 5(1). The judgment has been subject to strong criticism¹³⁰ and is problematic in several respects.¹³¹ As a decision of the Tax Court, the judgment does not create binding legal precedent (Hattingh, 2015:917).

When considering the creation of a PE of a partnership or the partners as a result of services rendered by the partners, it is therefore important to first ascertain whether the particular DTA under consideration contains a service PE clause. Secondly, it should be determined whether the services PE can apply to partners or only to employees / personnel. Once it has been established that a services PE clause could apply to services rendered by the partners, it has unfortunately not been definitively settled how a South African court should interpret such a clause. In light of the earlier decision in *Downing*, in which a court capable of creating legal precedent relied on the OECD commentary, the approach suggested in ITC 13276 (which does not constitute binding legal precedent) may not be appropriate. In particular, the importance of the commentary, which often clearly describes the purpose of a proposed provision, should not be underestimated in interpreting similar provisions contained in DTAs.

5.5 Conclusion

This chapter 5 considered in brief the meaning of a PE as contained in art 5 of the OECD, UN and SADC MTCs with particular focus on the attributes of a partnership that may be of relevance in the PE context. The term PE as contained in the UN and SADC MTCs is largely based on the wording and structure of the OECD MTC.

The existence of a PE in terms of a DTA allows the Contracting State in which the PE of an enterprise is located to exercise its taxing rights in relation to the business profits attributable to that PE. Business profits that are not attributable to a PE are only taxed in the state of residence.¹³² Business profits exclude all items of income that are specifically dealt with in terms of other articles in the MTCs.

¹²⁹ Convention between the Republic of South Africa and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, 1997.

¹³⁰ See Hattingh (2015: 911-955).

¹³¹ For example, the court relied on the US Technical Explanation, which is a unilateral document, in interpreting the DTA.

¹³² Article 7 of the OECD, UN and SADC MTCs.

The PE and source concepts should not be confused. In the previous chapter it was explained that source (which is a concept of domestic law) could serve as the connecting factor in relation to the presence or activities of non-residents in South Africa, thus providing South Africa with the requisite jurisdiction to tax and serving as a basis for the application of a DTA.

DTAs only apply to persons who are residents of a Contracting State. The term resident only extends to persons who are liable to tax in at least one of the Contracting States by reason of, for example, residence. Absent any special provisions in a particular DTA, fiscally transparent partnerships are excluded from claiming the benefits of a DTA as they are not liable to tax. Where the benefits of a DTA are denied to the partnership due to fiscal transparency, the individual partners may usually claim the benefits of the DTA.

In the context of a fiscally transparent partnership, each one of the partners will likely constitute an enterprise in relation to which a PE can potentially be created.

The general definition of a PE as contained in art 5(1) of the OECD, UN and SADC MTCs describes a PE as a fixed place of business through which the business of the enterprise is wholly or partly carried on. There are many intricacies in the interpretation of these terms. Significant in a partnership context is that extraordinary partners are usually not regarded as carrying on the business of the partnership. This cannot be remedied by the deeming provision contained in s 24H(2) of the Act as it would be inappropriate to rely on domestic provisions in the interpretation of DTAs that were negotiated bilaterally.

The dependent agent article (art 5(5)) is particularly relevant in a partnership context due to the mutual mandate that exists automatically amongst partners. Ordinary partners of a fiscally transparent partnership that habitually conclude contracts in the name of the partnership (ie their co-partners) in accordance with their implied authority (which is regarded as a form of actual authority) are at great risk of creating a PE for themselves and each one of their co-partners by virtue of art 5(5). This relevance of art 5(5) does not extend to extraordinary partners as extraordinary partners are not entrusted with managing the partnership business as agents of their co-partners. Furthermore, ordinary partners that conclude contracts in the name of the partnership, although potentially creating a PE for their ordinary co-partners, should not be able to create a PE for their extraordinary partners (who do not carry on the business of the partnership) by virtue of art 5(5).

The services PE clause, although not appearing in the OECD MTC, is included in certain DTAs that have been entered into by South Africa.¹³³ The wording of the services PE clause as currently contained in art 5(3)(b) of the UN and SADC MTCs relates to services rendered by employees of an enterprise for longer than certain periods of time. It would seem that partners of partnerships that are not regarded as legal

¹³³ For example, the DTAs entered into with the USA and the UK respectively.

entities will not be regarded as employees of that partnership. However, partners may potentially give rise to the creation of a PE in terms of art 5(3)(b) where they are also regarded as employees of a partnership that constitutes a legal entity.

It is evident that a PE can be created in terms of a number of different clauses as contained in art 5 of the different MTCs. When a particular DTA is being considered, the variations in wording and special provisions of that DTA should be carefully considered.

6. Conclusion

6.1 Introduction

This paper sought to establish whether the presence or activities of a partner or partners in South Africa creates (or is at risk of creating) a PE for that partner, the partnership or the co-partners in South Africa. The focus was on the key legal and fiscal attributes of a fiscally transparent partnership in the South African domestic context with the aim of identifying aspects specific to partnerships that may impact on the creation of a PE.

6.2 Summary of conclusions

It was established that certain aspects of a partnership are particularly relevant in the PE context. Moreover, different considerations apply between different kinds of partners (and partnerships), most notably between ordinary and extraordinary partners.

The provisions of the MTCs published by the OECD, UN and SADC respectively were used as guidelines for DTAs entered into with South Africa as one of the Contracting States. It was found that ordinary partners, by virtue of the implied authority arising from the partnership agreement, can be regarded as dependent agents who are therefore particularly at risk of creating a PE for themselves and their co-partners in terms of art 5(5) of DTAs based on these MTCs, provided they habitually exercise such authority. On the other hand, the so-called services PE as contained in art 5(3)(b) of the UN and SADC MTCs does not seem to be a comfortable fit for partners of a partnership that is not regarded as a legal entity. However, where the services PE clause appears in a slightly amended form in DTAs concluded by South Africa (eg by reference to individuals as opposed to employees), this may very well place partners at risk of creating a PE for the partnership or their co-partners if they render services in South Africa to the partnership (whether as their contribution to the partnership or otherwise) for a time period that exceeds the stipulated time period laid down in the particular DTA.

Whereas ordinary partners are particularly at risk of creating a PE for their co-partners, the opposite is true of extraordinary partners. This is, in short, because extraordinary partners would *normally* not be carrying on the business of the partnership, not be entrusted with the necessary authority to manage the business of the partnership and not render any services to the partnership. It should also be noted that the risk of ordinary partners creating a PE for their co-partners is more relevant to creating a PE for their ordinary co-partners as extraordinary partners (whose names and involvement in the partnership business are meant to be kept secret) often do not carry on the enterprise of the partnership.

6.3 Conclusions relative to research question

The law of partnership in South Africa is based on the common law as greatly influenced by the writing of Pothier. The legal consequences of a partnership flow from the partnership agreement, which does not create a legal entity under South African law. South Africa therefore follows the aggregate approach which views the partnership as an aggregate of the partners and not a legal person in and of itself. From this position in the common law it follows that a partnership is considered as fiscally transparent in South Africa, ie the income flows through the partnership, while retaining its nature, to be taxed in the hands of the individual partners.

An important distinction is drawn between ordinary and extraordinary partners. Extraordinary partners are not partners in the full sense of the word as they are not regarded as agents of their co-partners and moreover their co-partners are not regarded as their agents. One could in this sense regard extraordinary partners as passive investors in a partnership in relation to which many of the normal consequences of a partnership agreement would not apply.

On the other hand, an implied actual authority to conclude contracts related to the business of the partnership is automatically granted to the ordinary partners in a partnership by virtue of the partnership agreement. If such authority is habitually exercised, the ordinary co-partners of the partnership are particularly vulnerable to having a PE created for each of them. This is because in the context of a fiscally transparent partnership, the partners themselves are regarded as the relevant enterprises in relation to which a PE can be found to exist.

An important aspect that may sometimes be overlooked is that the provisions of a DTA cannot be relied on by a Contracting State in the absence of the requisite jurisdiction to tax. This is because DTAs do not introduce the right to tax but rather limit the right of a Contracting State to enforce domestic tax provisions, provided the DTA applies in the circumstances. In the absence of the requisite jurisdiction to tax, which can be established by way of tax residence or source, a state may not rely on the creation of a PE as a means of imposing tax.

In the context of cross-border partnerships, especially involving non-resident partners, the special rules surrounding the source of partnership income as developed under the common law was therefore considered, as well as the impact of legislation. It was found that, although the deeming source provisions contained in s 9 of the Act will have an impact on certain specific items of income flowing to the partners (such as deeming local dividends to be of a South African source), the source rules regarding the business profits of partnership income currently remain unaffected by s 9 of the Act. Moreover, s 24H of the Act concerning persons carrying on trade or business in a partnership, although of particular importance to the

domestic rules surrounding the taxation of partnership income in South Africa, does not affect the rules on the source of partnership income. Although subject to criticism, the position under South African domestic source rules therefore remains that the source of a partner's share of the business profits of a partnership is located where that partner carries on the business activities of the partnership.

Provided South Africa has the requisite jurisdiction to tax income in the hands of a particular partner, it is in each case of great importance to establish whether a PE for that partner in South Africa has been created by virtue of the presence or activities of the ordinary co-partners in South Africa, in which case the business profits attributable to that PE should be taxed only in the Contracting State where the PE is located.

6.4 Recommendations for future research

The taxation of cross-border partnerships remains subject to much uncertainty and further research is necessary. In particular, the consequences of having created a PE for the partnership or the partners is beyond the scope of this paper. It is recommended that further research be conducted on the attribution of income in the context where a PE has been created for a partnership or co-partners. The relevance of domestic source rules to the attribution of income to a partnership PE should also be investigated, especially in light of the unique source rules developed in relation to the source of partnership income as discussed in chapter 4 above. Included in the consequences of creating a PE for the co-partners in South Africa is the associated administrative burden of potentially having to register all the non-resident partners in a cross-border partnership for income tax in South Africa, especially where the partnership, having numerous non-resident partners, introduces but a few limited activities in South Africa. This is especially important as uncertainty relating to the administrative requirements may discourage cross-border partnerships from expanding their operations to South Africa.

Appendices

A. Section 24H of the Income Tax Act

24H. Persons carrying on trade or business in partnership.—(1) For the purposes of this section, “limited partner” means any member of a partnership *en commandite*, an anonymous partnership, any similar partnership or a foreign partnership, if such member’s liability towards a creditor of the partnership is limited to the amount which the member has contributed or undertaken to contribute to the partnership or is in any other way limited.

[Sub-s. (1) substituted by s. 46 (1) (a) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 October, 2011 in the case of any foreign partnership that is established or formed before 24 August, 2010, and with effect from the date of establishment or formation in the case of any foreign partnership that is established or formed on or after 24 August, 2010 (Editorial Note: effective date in s. 46 (2) (a) of Act No. 7 of 2010 as substituted by s. 164 (1) of Act No. 24 of 2011).]

(2) Where any trade or business is carried on in partnership, each member of such partnership shall, notwithstanding the fact that he may be a limited partner, be deemed for the purposes of this Act to be carrying on such trade or business.

(3) Notwithstanding anything to the contrary in this Act contained, the amount of any allowance or deduction which may be granted to any taxpayer under any provision of this Act in respect of or in connection with any trade or business carried on by him in a partnership in relation to which he is a limited partner shall not in the aggregate exceed the sum of—

(a) the amount, whether it consists of the taxpayer’s contribution to the partnership or of any other amount, for which the taxpayer is or may be held liable to any creditor of the partnership; and

(b) any income received by or accrued to the taxpayer from such trade or business.

[Sub-s. (3) amended by s. 26 of Act No. 74 of 2002.]

(4) Any allowance or deduction which has been disallowed under the provisions of subsection (3) shall be carried forward and be deemed to be an allowance or deduction to which the taxpayer is entitled in the succeeding year of assessment.

(5) (a) Where any income has in common been received by or accrued to the members of any partnership or foreign partnership, a portion (determined in accordance with any agreement between such members as to the ratio in which the profits or losses of the partnership are to be shared) of such income shall, notwithstanding anything to the contrary contained in any law or the relevant agreement of partnership, be deemed to have been received by or to have accrued to each such member individually on the date upon which such income was received by or accrued to them in common.

[Para. (a) substituted by s. 46 (1) (b) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 October, 2011 in the case of any foreign partnership that is established or formed before 24 August, 2010, and with effect from the date of establishment or formation in the case of any foreign partnership that is established or formed on or after 24 August, 2010 (Editorial Note: effective date in s. 46 (2) (a) of Act No. 7 of 2010 as substituted by s. 164 (1) of Act No. 24 of 2011).]

(b) Where a portion of any income is under the provisions of paragraph (a) deemed to have been received by or to have accrued to a taxpayer, a portion (determined as aforesaid) of any deduction or allowance which may be granted under the provisions of this Act in the determination of the taxable income derived from such income shall be granted in the determination of the taxpayer’s taxable income so derived.

[S. 24H inserted by s. 21 of Act No. 90 of 1988.]

B. Definition of a “foreign partnership” in terms of section 1 of the Income Tax Act

“foreign partnership”, in respect of any year of assessment, means any partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic if—

(a) for the purposes of the laws relating to tax on income of the country in which that partnership, association, body of persons or entity is formed or established—

(i) each member of the partnership, association, body of persons or entity is required to take into account the member’s interest in any amount received by or accrued to that partnership, association, body of persons or entity when that amount is received by or accrued to the partnership, association, body of persons or entity; and

(ii) the partnership, association, body of persons or entity is not liable for or subject to any tax on income, other than a tax levied by a municipality, local authority or a comparable authority, in that country; or

[Sub-para. (ii) substituted by s. 3 (1) (g) of Act No. 25 of 2015 deemed to have come into operation on 31 December, 2015 and applicable in respect of years of assessment ending on or after that date.]

(b) where the country in which that partnership, association, body of persons or entity is formed or established does not have any applicable laws relating to tax on income—

(i) any amount—

(aa) that is received by or accrued to; or

(bb) of expenditure that is incurred by,

the partnership, association, body of persons or entity is allocated concurrently with the receipt, accrual or incurral to the members of that partnership, association, body of persons or entity in terms of an agreement between those members; and

(ii) no amount distributed to a member of a partnership, association, body of persons or entity may exceed the allocation contemplated in subparagraph (i) after taking into account any prior distributions made by the partnership, association, body of persons or entity;

[Definition of “foreign partnership” inserted by s. 6 (1) (j) of Act No. 7 of 2010 with effect from the commencement of years of assessment commencing on or after 1 October, 2011 in the case of any foreign partnership that is established or formed before 24 August, 2010, and with effect from the date of establishment or formation in the case of any foreign partnership that is established or formed on or after 24 August, 2010 (Editorial Note: effective date in s. 6 (4) (a) of Act No. 7 of 2010 as substituted by s. 159 (1) (b) of Act No. 24 of 2011 deemed to have come into operation on 24 August, 2010) and substituted by s. 7 (1) (l) of Act No. 24 of 2011 deemed to have come into operation as from the commencement of years of assessment commencing on or after 1 October, 2011 in the case of any foreign partnership that is established or formed before 24 August, 2010, and as from the date of establishment or formation in the case of any foreign partnership that is established or formed on or after 24 August, 2010.]

C. Comparison of article 5 in terms of the current OECD, UN and SADC MTCs

Art 5	2014 OECD MTC	2011 UN MTC	2011 SADC MTC
(1)	For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.	For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.	For the purposes of this Agreement, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
(2)	The term “permanent establishment” includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.	The term “permanent establishment” includes especially: (a) A place of management; (b) A branch; (c) An office; (d) A factory; (e) A workshop; (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.	The term “permanent establishment” includes especially: (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; (f) a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources; and (g) an installation or structure used for the exploration for natural resources provided that the installation or structure continues for a period of not less thandays.
(3)	A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.	The term “permanent establishment” also encompasses: (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months; (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.	The term “permanent establishment” shall be deemed to include: a) a building site, a construction, assembly or installation project or any supervisory activity in connection with such site or project, but only where such site, project or activity continues for a period of more than months; (b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by an enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the Contracting State for a period or periods exceeding in the aggregate days in any twelve-month period commencing or ending in the fiscal year concerned; (c) for an individual, the performing of services in a Contracting State by that individual, but only if the individual's stay in that State, for the purpose of performing those services, is for a period or periods aggregating more than days within any twelve month period commencing or ending in the fiscal year concerned.

(4)	<p>Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:</p> <p>a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;</p> <p>b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;</p> <p>c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;</p> <p>d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;</p> <p>e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;</p> <p>f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.</p>	<p>Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:</p> <p>(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;</p> <p>(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;</p> <p>(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;</p> <p>(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;</p> <p>(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.</p> <p>(f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.</p>	<p>Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:</p> <p>(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;</p> <p>(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;</p> <p>(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;</p> <p>(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;</p> <p>(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.</p> <p>(f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.</p>
(5)	<p>Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.</p>	<p>Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 7 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:</p> <p>(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or</p>	<p>Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.</p>

		(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.	
(6)	An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.	Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.	An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.
(7)	The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.	An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.	Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 6 applies.
(8)		The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.	The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

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