SARS
South African Revenue Service

INTERPRETATION NOTE 116

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ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTIONS 49A to 49H
SUBJECT : WITHHOLDING TAX ON ROYALTIES

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Preamble

In this Note unless the context indicates otherwise –

- **"royalty"** means a royalty as defined in section 49A – see **4.1.2**;
- **"section"** means a section of the Act;
- **"TA Act"** means the Tax Administration Act 28 of 2011;
- **"tax treaty"** means an agreement for the avoidance of double taxation entered into between South Africa and another country;
- **"the Act"** means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

All guides, interpretation notes, forms and returns referred to in this Note are available on the SARS website at **www.sars.gov.za**. Unless indicated otherwise, the latest issue of these documents should be consulted.

1. Purpose

This Note provides guidance on the interpretation and application of sections 49A to 49H which relate to withholding tax on royalties.

An analysis and discussion of the impact of various tax treaties on withholding tax on royalties is beyond the scope of this Note. Should an arrangement between parties be subject to a tax treaty, the specific provisions of that treaty should be considered and applied.

2. Background

Broadly speaking, withholding tax on royalties applies to royalties from a source within South Africa paid by any person (whether a resident or not) to a foreign person for the use of intellectual property belonging to that person or for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service

in connection with the application or utilisation of such knowledge or information. Withholding tax on royalties can potentially be reduced or eliminated by a tax treaty.

Withholding tax on royalties was previously contained in section 35, which provided for a withholding rate of 12%. Owing to the need for uniformity between the different types of withholding taxes, the withholding regimes were amended. Section 35 was accordingly repealed[1] and replaced with sections 49A to 49H with effect from 1 July 2013.[2] The withholding rate was increased to 15% with effect from 1 January 2015.[3]

3. The law

The relevant sections of the Act are quoted in the **Annexure**.

4. Application of the law

4.1 Definitions

Section 49A contains definitions of "foreign person" and "royalty" which apply for the purposes of sections 49B to 49H.

4.1.1 "Foreign person"

The term "foreign person" is defined in section 49A as "any person that is not a resident".

The term "resident" is defined in section 1(1) and contains separate requirements for natural persons and persons other than natural persons. The term "person" includes a natural person, a deceased estate, an insolvent estate, a trust and a company but excludes a foreign partnership.[4]

A natural person is resident in South Africa when such person is –

- ordinarily resident[5] in South Africa; or
- not at any time during the relevant year of assessment ordinarily resident in South Africa, if that person was physically present[6] in South Africa –
  - ➢ for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and
  - ➢ for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment; and

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1 By section 65(1) of the Taxation Laws Amendment Act 22 of 2012.

2 By section 80(1) of the Taxation Laws Amendment Act 22 of 2012.

3 By section 97(1)(*b*) of the Taxation Laws Amendment Act 31 of 2013.

4 The full meaning of "person" has to be deduced from its ordinary dictionary meaning and from the inclusionary definitions of the term in section 1(1) and the Interpretation Act 33 of 1957.

5 See Interpretation Note 3 "Resident: Definition in Relation to a Natural Person – Ordinarily Resident".

6 See Interpretation Note 4 "Resident: Definition in Relation to a Natural Person – Physical Presence Test".

- a tax treaty does not deem that person to be exclusively a resident of another country for purposes of the application of any tax treaty.

A person other than a natural person is considered resident in South Africa, when it is –

- incorporated, established or formed in South Africa; or
- has its place of effective management[7] in South Africa; and
- a tax treaty does not deem that person to be exclusively a resident of another country for purposes of the application of any tax treaty.

4.1.2 "Royalty"

The term "royalty", as defined in section 49A, means –

> "any amount that is received or accrues in respect of—
>
> (*a*) the use or right of use of or permission to use any intellectual property as defined in section 23I; or
>
> (*b*) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information".

Paragraphs (*a)* and *(b*) of the definition are not mutually dependent. The use of the word "or" highlights that the paragraphs must be applied independently of each other. In addition, the knowledge or information referred to in paragraph (*b*) could be related to the intellectual property under paragraph (*a*), but paragraph (*b*) does not contain any restrictive wording to limit it to such intellectual property. The scientific, technical, industrial or commercial knowledge or information could therefore be unrelated to items included in the definition of intellectual property in section 23I. It is also not a requirement that the information be imparted to a person that has use, right of use or permission to use intellectual property under paragraph (*a*).

The amount that is received or accrued can be of a recurring or once-off nature.

The payment of a royalty as defined must be distinguished from the payment of amounts, which although labelled a royalty, do not meet the definition contained in section 49A. For example, payments under a lease agreement with a satellite operator or telecommunication operator for the use of the transponder capacity or network capacity or payments under an agreement granting an exclusive distribution right will not qualify as a royalty as defined. Paragraph (*a*) of the definition in section 49A includes only payments for use, right of use or permission to use intellectual property as defined in section 23I, and the definition in section 23I is restricted to specified types of property [see **4.1.2(e)**]. Transponders, networks and distribution rights are not included in the types of property included in intellectual property in paragraph (*a*) and do not constitute the knowledge, information, services or assistance included in paragraph (*b*).

Some agreements between the parties may cover a combination of rights, knowledge, information and services of which only part of the amount paid falls within the ambit of a royalty. In such instances, only the payment for the elements which constitute a royalty will potentially be subject to the withholding tax on royalties. If the agreement

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[7] See Interpretation Note 6 "Resident: Place of Effective Management (Companies)".

contains a single amount for all the rights, knowledge, information and services, a reasonable apportionment will be required. The appropriateness of the method applied to apportion the amount must be assessed on a case-by-case basis.

The main elements of the definition of "royalty" are considered further in **4.1.2(a)** to **4.1.2(e)**.

In determining whether a particular amount is a royalty, it is critical to understand in detail what the payment is for and the nature of the rights, if any, obtained before the principles considered above are applied. While the principles are useful, the facts of each case are usually unique and varied and therefore a proper analysis and determination can be done only on a case-by-case basis.

(a) "Amount"

The word "amount" as used in the context of gross income has been the subject matter of various court cases. The principles established in those cases are applicable in the context of the definition of a "royalty".

The word "amount" was considered in *Lategan v CIR* in which Watermeyer J stated the following:[8]

> "In my opinion, the word 'amount' must be given a wider meaning, and must include not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value."

This principle was reiterated in *CIR v People's Stores (Walvis Bay) (Pty) Ltd*[9] in which it was confirmed that income, although expressed as an "amount" in the definition of "gross income", includes more than just money but may be every form of property earned by the taxpayer which has a money value. Every form of property includes corporeal and incorporeal property as well as debts and rights of action.

In *C: SARS v Brummeria Renaissance (Pty) Ltd & others*,[10] it was held that even though a receipt or accrual cannot be turned into money, it does not mean that the receipt or accrual does not have a monetary value. It was also held that an objective test must be applied when determining whether an amount has a money value.

Therefore, a taxpayer receiving an amount of gross income[11] in the form of an asset or services must include the market value of the asset or services in gross income.[12]

Similarly, "amount" in the definition of "royalty" includes an amount of money and the monetary value of every form of property that is received or accrued in respect of the items included in the definition. For example, the market value of an asset given or service rendered to the owner of intellectual property in exchange for the use of that property would constitute an amount received as a royalty.

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[8] 1926 CPD 203, 2 SATC 16 at 19.

[9] 1990 (2) SA 353 (A), 52 SATC 9 at 21.

[10] 2007 (6) SA 601 (SCA), 69 SATC 205.

[11] The requirements for an amount to constitute gross income are included in the definition of that term in section 1(1).

[12] See *Lace Proprietary Mines Ltd v CIR* 1938 AD 267, 9 SATC 349.

(b) "Received or accrues"

The words "received" and "accrues" are not defined in the Act but have received judicial consideration.

In *Geldenhuys v CIR*, Steyn J stated that the words "received by" must mean –[13]

> "received by the taxpayer on his own behalf for his own benefit".

In *CIR v Genn & Co (Pty) Ltd*, Schreiner JA stated the following:[14]

> "It certainly is not every obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income."

In *WH Lategan v CIR*, Watermeyer J stated the following on the meaning of "accrued":[15]

> "In his Lordship's opinion the words in the Act 'has accrued to or in favour of any person' merely meant 'to which he has become entitled'."

Thus, a royalty includes any amount received by a person on that person's own behalf and for that person's own benefit as well as those amounts that the person is unconditionally entitled to but which have not yet been received.

The levying of withholding tax on royalties is triggered on the earlier of payment of the royalty or when the royalty becomes due and payable. In relation to "due and payable", the point in time at which a royalty is due and payable may be later than the point in time at which it accrues to a person (see **4.2** and **4.3**).

(c) "In respect of"

The words "in respect of" have been considered in many cases. Viviers J in ITC 1340 summarised the position as follows:[16]

> "As was pointed out by Solomon JA in *CIR v Crown Mines Ltd* 1923 AD 121 at 128, the expression 'in respect of' may be used in various senses, and in each case it is necessary to examine the context in order to ascertain the sense in which it is used. … I need refer only to two of the more recent decisions … *SBI v Raubenheimer* 1969 (4) SA 314 (A) at 320 (31 SATC 209) and *SIR v Wispeco Housing (Pty) Ltd* 1973 (1) SA 783 (A) where Ogilvie Thompson CJ said the following at 792:
>
> > 'No doubt the expression "in respect of" must, in certain contexts, be restricted to a direct or causal relationship (cf eg *De Villiers v CIR* 1929 AD 227 at 229); but, as was pointed out in *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301 at 320, the expression "in respect of" does not necessarily or invariably indicate such relationship. In that case, it was held to be used in the sense of "in relation to" or "in reference to". (Cf also *SBI v Raubenheimer* . . .) The expression "in connection with" *prima facie* extends the ambit of matters comprehended *in casu*,…'
>
> As appears from all the aforegoing, the context wherein the expressions 'in respect of' and 'in connection with' occur is of vital importance."

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13 1947 (3) SA 256 (C), 14 SATC 419 at 430.

14 1955 (3) SA 293 (A), 20 SATC 113 at 123.

15 1926 CPD 203, 2 SATC 16 at 20. The entitlement principle was confirmed in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 19.

16 (1980) 43 SATC 210 (C) at 212.

Taking the principles from these cases and the purpose of the section into account, in the context of the definition of "royalty" in section 49A, "in respect of" must be interpreted as requiring a causal connection between the amount received or accrued and the items specified in paragraph (*a*) and paragraph (*b*) of that definition.

(d) "Use or right of use or permission to use"

With transactions involving the use of intellectual property, the person legally entitled to use the property is generally obliged to make recurring payments to the owner for the use of that property. However, the definition of a royalty is not restricted to recurring payments and also includes once-off payments for the use, right of use or permission to use intellectual property.

Under paragraph (a) of the definition of "royalty", a payment for the use, right of use or permission to use intellectual property as defined in section 23I is a royalty. A person who pays someone for the use of intellectual property is not given ownership of that property. Ownership remains with the owner at all times during the agreement as well as upon its termination.

A transaction which involves the full transfer of ownership of the intellectual property is not for the use, right to use or permission to use the intellectual property even though the use of the item is one of the rights which is transferred.

(e) "Intellectual property"

The definition of "royalty" in section 49A refers to intellectual property as defined in section 23I. Section 23I defines "intellectual property" as any –

> "(*a*) patent as defined in the Patents Act including any application for a patent in terms of that Act;
>
> (*b*) design as defined in the Designs Act;
>
> (*c*) trade mark as defined in the Trade Marks Act;
>
> (*d*) copyright as defined in the Copyright Act;
>
> (*e*) patent, design, trade mark or copyright defined or described in any similar law to that in paragraph (*a*), (*b*), (*c*) or (*d*) of a country other than the Republic;
>
> (*f*) property or right of a similar nature to that in paragraph (*a*), (*b*), (*c*), (*d*) or (*e*); and
>
> (*g*) knowledge connected to the use of such patent, design, trade mark, copyright, property or right;".

The following words, as defined in their respective Acts, should be noted:

- A "patent" means "a certificate in the prescribed form to the effect that a patent for an invention has been granted in the Republic".[17]
- A "design" means "an aesthetic design or a functional design".[18]
    - An "aesthetic design" means "any design applied to any article, whether for the pattern or the shape or the configuration or the ornamentation thereof, or for any two or more of those purposes, and by whatever

[17] Definition of "patent" in section 2 of the Patents Act 57 of 1978.
[18] Definition of "design" in section 1(1) of the Designs Act 195 of 1993.

means it is applied, having features which appeal to and are judged solely by the eye, irrespective of the aesthetic quality thereof".[19]

- A "functional design" means "any design applied to any article, whether for the pattern or the shape or the configuration thereof, or for any two or more of those purposes, and by whatever means it is applied, having features which are necessitated by the function which the article to which the design is applied, is to perform, and includes an integrated circuit topography, a mask work and a series of mask works".[20]

- A "trade mark" is defined in the Trade Marks Act[21] and includes a "trade mark", a "certification trade mark" and a "collective trade mark".
  - A "trade mark", other than a certification trade mark or a collective trade mark, means "a mark used or proposed to be used by a person in relation to goods or services for the purpose of distinguishing the goods or services in relation to which the mark is used or proposed to be used from the same kind of goods or services connected in the course of trade with any other person".[22]
  - A "certification trade mark" means "a mark registered or deemed to have been registered under section 42".[23]
  - A "collective trade mark" means "a mark registered under section 43".[24]
- A "copyright" means "copyright under this Act".[25] The following original works are potentially eligible for copyright - literary works, musical works, artistic works, cinematograph films, sound recordings, broadcasts, programme-carrying signals, published editions and computer programs.[26]

Paragraph (*e*) of the definition of "intellectual property" includes intellectual property that is defined or described in any similar international legislation. In the United Kingdom, for example, a creator's artistic, literary, dramatic and musical work is protected by the Copyright, Designs and Patents Act, 1988. By applying paragraph (*e*), these works will also be regarded as intellectual property as defined in section 23I.

Further, paragraph (*f*) of the definition of "intellectual property" includes "property or right of a similar nature". This concept was analysed in *C: SARS v SA Silicone Products (Pty) Ltd* in which Heher JA stated the following:[27]

> "The expression, properly interpreted, requires, in my view, that any property which is similar in nature shall possess fundamental characteristics common to those possessed by the specifically identified properties; minor or superficial similarities will not of themselves suffice…The common natures of the identified properties…embrace their intellectual origins, *ie* their derivation from a creative mind, their potential for commercial exploitation, the fact that the law regards such exploitation as creating a justifiable monopoly which is available only to the creator of the property or persons to

[19] Definition of "aesthetic design" in section 1(1) of the Designs Act 195 of 1993.
[20] Definition of "functional design" in section 1(1) of the Designs Act 195 of 1993.
[21] 194 of 1993.
[22] Definition of "trade mark" in section 2(1) of the Trade Marks Act 194 of 1993.
[23] Definition of "certification trade mark" in section 2(1) of the Trade Marks Act 194 of 1993.
[24] Definition of "collective trade mark" in section 2(1) of the Trade Marks Act 194 of 1993.
[25] Definition of "copyright" in section 1(1) of the Copyright Act 98 of 1978.
[26] Section 2 of the Copyright Act 98 of 1978.
[27] [2004] 2 All SA 1 (SCA), 66 SATC 131 at 139.

> whom the creator transfers his rights according to law and that the law accords the rights and protection of ownership to such property."

Paragraph (*g*) of the definition of "intellectual property" in section 23I refers to the knowledge connected to the use of the intellectual property included in paragraphs (*a*) to (*f*) of that definition. The knowledge within the ambit of paragraph (*g*) is therefore directly linked to what is contained in the preceding paragraphs of that definition.

This differs from the relationship between paragraph (*a*) and paragraph (*b*) of the definition of "royalty" in section 49A. Paragraphs (*a)* and *(b*) of the definition of "royalty" are not mutually dependent. The use of the word "or" highlights that paragraph (*a*) and (*b*) must be applied independently of each other. In addition, paragraph (*b*) does *not* contain any wording which restricts the scientific, technical, industrial or commercial knowledge or information to items included in the definition of intellectual property in section 23I or, for example, that requires the information to be imparted to a person that has use, right of use or permission to use intellectual property under paragraph (*a*).

The use of computer software and programs must be considered carefully to determine whether it is covered by the definition. The question which often needs to be determined is whether the payee has acquired the right to use, for example, the copyright under paragraph (*a*) of the royalty definition or alternatively knowledge or information which falls under paragraph (*b*) of that definition, or whether they have merely acquired the right to use a product which itself uses something falling within paragraph (*a*) or (*b*). Stated widely and generally, the question is whether one has use of the copyright or use of a copyrighted article. For example, payment for the use of a program such as the algorithms or programming language which the payer then uses in developing a software package would generally constitute a royalty. In contrast, payment for the right to use a software product, for example, an accounting software package, would generally not constitute a royalty because the use or the right of use does not relate to the use and exploitation of something falling within paragraph (*a*) or (*b*) of the definition such as the program.[28] The facts of each case will dictate whether an agreement falls within the ambit of the definition. This principle is not limited to copyrights and, depending on the facts, may also apply to other types of intellectual property.

Each case must be considered on its merits when applying the above criteria.

(f) "Scientific, technical, industrial or commercial knowledge or information"

Under section 49A, any amount received by or accrued to a person for imparting or undertaking to impart any knowledge or information of a scientific, technical, industrial or commercial nature constitutes a royalty.

Lexico.com defines "impart" as meaning –[29]

> "1. Make (information) known".

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[28] For more information on whether payments received as consideration for computer software may be classified as royalties, see paragraph 12 – 14 of the Commentary on Article 12 of the OECD Model Tax Convention in which this issue has been extensively considered.

[29] **www.lexico.com/en/definition/impart** [Accessed 22 April 2021].

Thus, a payment received by or accrued to a person for "making known" scientific, technical, industrial or commercial knowledge or information will constitute a royalty. A distinction must be drawn between circumstances in which a person is paid for the service of conveying knowledge that is already in the public domain and those in which a person is paid for sharing knowledge that is not generally available. With the former the payment will generally not constitute a royalty, while with the latter the payment will generally constitute a royalty. The facts of a particular case will determine whether the distinction can be easily made or whether it will require a more complex analysis.

For example, an amount paid to a foreign lecturer to deliver a paper on specific tax treaties and the OECD Model Convention, is likely to be remuneration for services rendered and not a royalty. In contrast, an amount paid to a person for knowledge which is not in the public domain, for example, a trade secret, regardless of whether it is registered, or a combined fee paid for knowledge of a trade secret and holding sessions in South Africa during which such knowledge is conveyed and questions regarding its application and utilisation are dealt with, will generally constitute a royalty. In making a determination whether a particular amount is a royalty, it is necessary to consider all the detailed facts.

A service agreement under which a party undertakes to use customary skills to execute the work differs from an agreement falling within paragraph (*b*) of the definition of "royalty" in which a person undertakes to impart knowledge or information to another person. The Commentary on the OECD Model Tax Convention provides some guidelines for distinguishing between payments for the supply of know-how and payments for the provision of services. These guidelines can be useful in determining whether a payment is made for imparting knowledge or information or rendering services and hence whether it falls inside the definition of "royalty" in section 49A. Paragraph 11.3 of the Commentary on Article 12 provides as follows:

- "Contracts for the supply of know-how concern information of the kind described in paragraph 11 [*information concerning industrial, commercial or scientific experience]* that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.
- In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.
- In most cases involving the supply of know-how, there would generally not be much more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a very much greater level of expenditure by the supplier in order to perform the supplier's contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services."

Some examples of such service agreements include those covering after-sales services, services under a warranty and pure technical assistance.[30]

As noted in **(e**), paragraph (*b*) of the definition of royalty in section 49A does not restrict the imparting of the specified knowledge or information, or the undertaking to do so, to circumstances in which that specified information or knowledge is linked to items included in the definition of intellectual property in section 23I and does not require that the knowledge or information must be imparted to a person that has use, right of use or permission to use such intellectual property. See also the comments in **(e)** regarding computer software and programs.

In addition, an amount will be regarded as a royalty if it is received by or accrued to a person who provides or agrees to provide any assistance or service relating to the application or use of the knowledge or information. The assistance or service referred to relates to the application or use of the specified knowledge or information and must be distinguished from the instance in which only assistance or service of a pure technical nature is provided without being linked to the application or use of the specified knowledge or information (see **4.1.2**).

The term "knowledge" is defined by *Lexico.com* as follows:[31]

> "1 Facts, information, and skills acquired through experience or education; the theoretical or practical understanding of a subject."

The term "information" is defined in *Lexico.com* as follows:[32]

> "1 Facts provided or learned about something or someone."

The words "scientific, technical, industrial or commercial" are not defined in the Act. It is submitted that the ambit of scientific, technical, industrial or commercial knowledge or information is very wide. The knowledge or information may relate to, but is not restricted to, items of intellectual property as defined in section 23I and included in paragraph (*a*).

4.2 Levy of withholding tax on royalties

In order for an amount to be liable to withholding tax on royalties –[33]

- there must be an amount [see **4.1.2(a)**];
- the amount must constitute a royalty (see **4.1.2)**;
- the amount must be paid by any person (see **4.3**);
- to or for the benefit of any foreign person (see **4.4**);
- to the extent that the amount is regarded as having been received by or accrued to that foreign person from a source within South Africa under section 9(2)(*c*), (*d*), (*e*) or (*f*) (see **4.5**).

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30 See paragraph 11.4 of the Commentary on Article 12 of the OECD Model Tax Convention for additional examples.

31 **www.lexico.com/en/definition/knowledge** [Accessed 22 April 2021].

32 **www.lexico.com/en/definition/information** [Accessed 22 April 2021].

33 Section 49B(1)(*a*).

These requirements and the computation of the amounts of withholding tax on royalties are considered below.

Withholding tax on royalties is a final tax[34] currently levied at the rate of 15%[35] of the amount meeting the requirements listed above. The rate of 15% may be altered by legislative amendment or the Minister of Finance may announce a new rate in the national annual budget which is effective on the date mentioned in the announcement. In the latter case, the new rate continues to apply for 12 months from that date subject to Parliament passing legislation which gives effect to the announcement within that 12-month period.[36]

When a person withholds an amount of withholding tax on royalties as contemplated in section 49E(1), that person is, for the purposes of withholding tax on royalties, deemed to have paid the amount so withheld to or for the benefit of a foreign person.[37] Withholding tax on royalties is therefore levied on, and withheld from, the gross amount of the royalty.

See **4.7.1** for "Liability for withholding tax on royalties" and **4.7.2** for "Liability to withhold the tax".

4.3 "Paid by any person"

Under section 49B(2) the payment of the royalty is deemed to be made on the earlier of the date on which it –

- is paid; or
- becomes due and payable.

4.3.1 Paid

An amount can be paid in a variety of ways, including in cash, in kind, in the form of set-off or by agreeing that the amount may be retained as a loan.[38] There is generally little difficulty in determining the date of payment when expenditure is paid in cash, which in practice is often the case with royalty payments. However, the date of payment can be more difficult to establish when payment is in a form other than cash and in these instances the importance of the facts of the particular case should not be lost sight of.

ITC 1688[39] set out some useful principles for determining the date of payment when payment is in the form of set-off, cheque[40] or by way of a loan. In this case the appellant company declared two dividends to the sole holder of its shares on 2 March 1992 and 5 March 1993, respectively. Payment of these dividends was not made in cash or by

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34 Section 49B(3).

35 Royalties paid or which became due and payable on or after 1 July 2013 but before 1 January 2015 attracted a withholding rate of 12%. The rate of 15% or 12%, as the case may be, is subject to any reduction required by an applicable tax treaty.

36 Section 49B(1)(*b*).

37 Section 49B(4).

38 See the commentary below on ITC 1688 (1999) 62 SATC 478 (N). Although that case relates to whether a dividend was "paid" for the purposes of secondary tax on companies (since repealed), the principles regarding payment apply when considering when the royalty will be considered "paid" for purposes of withholding tax on royalties.

39 (1999) 62 SATC 478 (N).

40 With effect from 1 January 2021 cheques are no longer an acceptable form of payment or bill of exchange in South Africa.

cheque. Rather, the resolutions declaring the dividends provided that payment of the dividends would be effected by crediting the holder's loan account. Journal entries were duly effected giving credit to the holder of the shares, but the holder's loan account was credited only on 31 July 1993.

At issue was whether the dividends were subject to STC which came into operation on 17 March 1993. The relevant legislation provided that dividends declared before 17 March 1993 that were paid on or after that date, were deemed to be declared on 17 March 1993, thus making them potentially subject to STC. The crisp issue was whether the dividends were paid before 17 March 1993.

In delivering his judgment Galgut J stated the following about the nature of payments generally:[41]

> "The determination of the date upon which a payment is made is of course a question of fact. When payment of a dividend is made in cash there can of course be no difficulty in determining the date of such payment. The same applies to a payment by cheque, even if the cheque is post-dated or dishonoured, because payment will be effected when the proceeds of the cheque are received by or on behalf of the payee.
>
> Payment can of course be made other than in cash or by cheque. There are a number of possibilities. To take but one, it might happen for example that a shareholder owes his company money, and that the company thereafter becomes indebted to the shareholder by the declaration of a dividend. In such a case the company may elect to effect a set-off, provided of course all of the other requisites for a set-off are present. One such requisite is that both debts must be fully due. In such a case the shareholder would have no choice because, as was said in *Lester Investments (Pty) Ltd v Narshi* 1951 (2) SA 464 (C) at 472B-C, set-off operates *ipso jure*,[42] and it is effective from the date upon which the parties became mutually indebted to each other. It would therefore operate without the shareholder's consent, and what is more it would operate immediately upon the declaration of the dividend. If the debt owing by the shareholder is recorded in a loan account with the company, then the set-off will be recorded by crediting the taxpayer's loan account in the amount concerned.
>
> It is important to emphasise, however, that such crediting is no more than a recording of a pre-existing fact, so that the operation of the set-off will not depend upon the crediting of the loan account.
>
> As distinct from the operation of a set-off, or from the tender of cash or (subject to certain qualifications which are not relevant for present purposes) a cheque, all other forms of payment can only discharge a debt if the creditor agrees thereto. One such agreement is where the creditor agrees, as in the present case, to lend the money concerned to the debtor, where he agrees in other words that the debtor may retain the money as a loan. In such an event, as in the case of a set-off, both the payment of the dividend and the advancing of the loan in each instance take place automatically, and as such they are effected *pari passu* with the conclusion of the agreement. As such, and this must be emphasised, payment is in each case effected on the date upon which the agreement is concluded. It would of course be otherwise were the resolution whereby the dividend is declared to contain a term showing that the dividend is to be paid at some date thereafter, or were the agreement of loan to contain a term showing that the loan would similarly be delayed. In the absence of such an indication, in the absence in other words of anything to show that the parties intended otherwise, it would be fair to conclude that both the payment of the dividend and the reciprocal advancing of the loan occurred, and were intended to occur, then and there."

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[41] At 481.

[42] By operation of law.

In summary, the court held that payments in a form other than cash, cheque[43] or set-off can discharge a debt only with the creditors consent. Based on the facts of the case the court found that this took place when the respective resolutions were passed and not when the physical crediting of the loan account took place and accordingly found in favour of the appellant.

In concluding the court stated the following:[44]

> "I should emphasise finally that nothing I have said should be understood to mean that where declared dividends are left on loan in a company, it will be presumed or will necessarily mean that payment takes place at the time the dividend is declared. At the risk of repeating myself I stress that the date of payment is a question of fact, and that as such the date must be determined on the particular facts of each case."

The judge's concluding comments highlight that the outcome of ITC 1688 may have been different had the resolution contained a term indicating that payment would be made at a later date. This case emphasised the importance of the facts of the particular case in determining when an amount is considered to be paid and highlighted that the crediting of a loan account will not always necessarily constitute payment.

Similarly, royalties may have accrued to a recipient and be payable as opposed to paid. Payment by way of agreeing to retain the amount as a loan must be distinguished from an accrual. The former means the amount will have been paid and therefore withholding tax will be triggered, while a mere accrual which is not a payment will not trigger withholding tax on royalties. The *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2012 in discussing the rationalisation of withholding taxes on payments to foreign persons and the changes to withholding tax on royalties stated the following:

> "[A] mere accrual will no longer be the basis for withholding. In line with the new Dividends Tax, the trigger date for withholding will now be the date that a sum is paid or becomes due and payable."

Example 1 – Determination of when a royalty is considered "paid" for purposes of withholding tax on royalties

Facts:

P, a resident of Country K, granted Company F, a South African resident, the use of its registered patent on 1 January 2020. Company F's year of assessment ends on 31 December 2020. According to the agreement entered into by P and Company F, P is entitled to a monthly royalty of R10 000. Further, the royalty which accrues between 1 January and 31 December each year is due and payable 4 months after the calendar year end. Therefore, the royalty which accrued for the year ending 31 December 2020 was due and payable on 30 April 2021. However, Company F decided to pay the amount on 31 March 2021.

There is no tax treaty between Country K and South Africa.

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43 Subject to certain qualifications not relevant to the decision.

44 At 482.

Result:

Section 49B(1)(*a*) requires withholding tax on royalties to be levied on royalties paid to or for the benefit of a foreign person. A royalty is deemed to be paid for the purpose of withholding tax on royalties on the earlier of the date on which it is actually paid or becomes due and payable. Accordingly, withholding tax must be levied and withheld from the payment of the royalty made on 31 March 2021, since the actual date of payment is earlier than the date on which the royalty is due and payable.

The accrual of the royalty during the 2020 year of assessment does not comprise payment based on the facts of this case and therefore does not trigger withholding tax during or at the end of the 2020 year of assessment.

4.3.2 Due and Payable

The words "due" and "payable" have been considered in various judgments. In *CIR v Janke*[45] Stratford J cited the following observation of Searle J in *Stafford v Registrar of Deeds*:[46]

> "It is clear that the word 'payable' is sometimes construed as meaning 'payable at a future time' or 'in respect of which there is a liability to pay'. It is also true that it is sometimes used to mean 'payable immediately' or 'actually due and presently demandable'."

In *Singh v C: SARS*, Olivier JA stated the following:[47]

> "The word 'payable' can have at least two different meanings, viz '. . . (a) that which is due or must be paid, or (b) that which may be paid or may have to be paid . . . The sense of (a) is a present liability – due and payable – . . . (b) . . . a future or contingent liability'."

An amount may thus be due under a contract (*dies cedit*) but not payable (*dies venit*). An amount will be payable only when the time for payment arrives. For an amount to be "due and payable" the amount must not only be owing, but a person must have the right to claim payment of it.[48]

Example 2 – Deemed payment of a royalty and the rate of withholding tax to be levied

Facts:

X, a resident of Country Q, entered into an agreement with B, a South African resident, entitling B to make use of X's intellectual property. According to the agreement, X is entitled to receive royalties from B for the use of the property. The payment of the royalties was required to be made by 31 July 2020. B actually made payment on 15 July 2020.

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45 1930 AD 474, 4 SATC 269 at 276.

46 1913 CPD 329.

47 2003 (4) SA 520 (SCA), 65 SATC 203 at 216.

48 L Mitchell 'Cash Consideration Only' (2005) 19 *Tax Planning* 84.

Result:

Under section 49B(2), a royalty is deemed to be paid on the earlier of the date on which it is paid (15 July 2020) or when it becomes due and payable (31 July 2020). The royalty is thus deemed to be paid to X on 15 July 2020.

Since the payment was made on or after 1 January 2015, tax at the rate of 15% was required to be withheld from the royalty.

4.4 Meaning of "to or for the benefit of any foreign person"

The phrase "to or for the benefit of any foreign person" requires withholding tax on royalties to be levied on royalties paid to a foreign person beneficially entitled to it and royalties paid to another person for the benefit of a foreign person. As a result, the royalty need not be paid directly to the foreign person but can also be paid to, for example, the foreign person's nominee, representative or agent.

The withholding obligation (see **4.7.2**) is placed on the payer of the royalty, and not the person that receives it for their own benefit or, generally, that receives it on behalf of another.

If a royalty is paid to a trust there are a number of factors to consider when determining whether the payment is to or for the benefit of a foreign person, such as, whether the trust itself is resident in South Africa or a foreign person, the type of trust, whether the beneficiaries are resident in South Africa or elsewhere and whether the income is vested in beneficiaries.

For example, in the case of a vesting trust which confers a vested right to a royalty on a beneficiary, the payer must assess if that beneficiary is a foreign person and, if so, then the royalty will be to or for the benefit of a foreign person (see Examples 3 and 4).

Example 3 – Royalty paid to a vesting trust

Facts:

Z Trust, a South African registered and resident trust, has one beneficiary, D. D, a resident in Foreign Country N, has a vested right to the trust's capital and income. Z Trust owns a patent which it granted S, a South African resident, the use of on 1 March 2020. S incurred a monthly royalty which was payable at the end of the first month after the end of the financial year in respect of which it was incurred. S's financial year ends February each year. The first payment was due and payable and was paid on 31 March 2021.

There is no tax treaty between South Africa and Foreign Country N. S used the patent in South Africa.

Result:

Section 49B(1)(*a*) requires withholding tax on royalties to be levied on South African-sourced royalties paid to or for the benefit of a foreign person. The royalty is deemed to be paid for the purpose of withholding tax on royalties on the earlier of the date on which it is actually paid or becomes due and payable.

Under section 25B(1) if any amount, is received by or accrues to a trust and a beneficiary has a vested right to that amount during that year of assessment, such amount is deemed to accrue to that beneficiary and not that trust. Given that D has a vested right to the royalty, Z Trust is merely acting as a conduit and receiving the royalty on behalf of D, who is a foreign person. Accordingly, S, as the person making the payment of royalty, must withhold withholding tax on royalties at 15% on the payment of the royalties on 31 March 2021 under section 49E(1) and pay it over to SARS under section 49F(2).

Example 4 – Royalty paid to a vesting trust

Facts:

Z Trust, a South African registered and resident trust, has two beneficiaries, A and D. A is resident in South Africa, D is resident in Foreign Country N. A and D each have a vested right to 50% of the trust's capital and income.

Z Trust owns a patent which it granted S, a South African resident, the use of on 1 March 2020. S incurred a monthly royalty which was payable at the end of the first month after the end of the financial year in respect of which it was incurred. S's financial year ends February each year. The first payment was due and payable and was paid on 31 March 2021.

There is no tax treaty between South Africa and Foreign Country N. S used the patent in South Africa.

There is no tax treaty between South Africa and Foreign Country N.

Result:

Section 49B(1)(*a*) requires withholding tax on royalties to be levied on South African-sourced royalties paid to or for the benefit of a foreign person. The royalty is deemed to be paid for the purpose of withholding tax on royalties on the earlier of the date on which it is actually paid or becomes due and payable.

Under section 25B(1) if any amount, is received by or accrues to a trust and a beneficiary has a vested right to that amount during that year of assessment, such amount is deemed to accrue to that beneficiary and not that trust. Given that A and D each have a vested right to 50% of the royalty, Z Trust is merely acting as a conduit and receiving the royalty on behalf of A and D.

Accordingly, S, as the person making the payment of royalty, must withhold withholding tax on royalties at 15% on the payment of 50% of the royalties which are vested in D, a foreign person, on 31 March 2021 under section 49E(1) and pay it over to SARS under section 49F(2). S must not withhold withholding tax on royalties at 15% on the payment of 50% of the royalties which are vested in A, a resident.

The position with discretionary trusts can practically be complicated as a result of the interaction between the withholding tax provisions and section 25B. This arises because sometimes when the payer pays the royalty, or it becomes due and payable, it appears as if it is for the benefit of the trust. However, depending on whether and when the trustees exercise their discretion, this can change such that section 25B

deems the amount to have accrued to the beneficiary and therefore it is for the beneficiary's benefit and not the trust.

For example, a resident discretionary trust receives a royalty during the year of assessment. After receiving the royalty but before the end of the trust's year of assessment, the trustees exercise their discretion to vest the royalty in the beneficiary. Section 25B(1), read with section 25B(2), deems the amount to have accrued to the beneficiary and not the trust. Accordingly, it is the identity of beneficiary that must be considered when assessing whether the royalty is "to or for the benefit of a foreign person". The complexity arises because section 25B can deem the amount to have accrued to the beneficiary after it was actually paid to the trust and whilst the trust in this example is a resident, the beneficiary in which the royalty was vested may not be a resident.

If the trustees in the above example exercised their discretion to vest the royalty in a beneficiary after the end of the trust's year of assessment, the royalty is deemed to accrue to the trust [section 25B(1)]. Accordingly, it is the identity of the trust that must be considered when assessing whether the royalty is "to or for the benefit of any foreign person".

In the context of discretionary trusts and vesting, an important point is that the trigger for withholding tax on royalties remains "paid", being the earlier of paid and due and payable. The time of payment may be different to the time at which vesting takes place. For example, payment may take place in a year of assessment after the year of assessment in which the trustees exercise their discretion and vest the royalty in a beneficiary. Payment could also be triggered before vesting occurs (see Example 5).

Example 5 – Royalty paid to a resident discretionary trust

Facts:

Z Trust, a South African registered and resident trust, is a discretionary trust with two discretionary beneficiaries, D and C. D is resident in Foreign Country N and has not visited South Africa in the last 2 years. C is resident in South Africa.

Z Trust granted S, a South African resident, the use of its registered patent on 1 March 2020 in return for a monthly royalty. Monthly royalties are payable at the end of the first month after the end of S's financial year in respect of which it was incurred. S's financial year ends December each year. The first payment for royalties incurred in respect of the 2020 year was due and payable and was paid on 31 January 2021.

The trustees met on 28 February 2021 and vested the royalty income in D. Z Trust's year of assessment ends on the last day of February each year.

There is no tax treaty between South Africa and Foreign Country N.

Result:

Section 49B(1)(*a*) requires withholding tax on royalties to be levied on royalties paid to or for the benefit of a foreign person.

In these circumstances, at the date of making the royalty payment, S made the payment to a resident, Z Trust, and was not aware that the royalty might ultimately be vested in D and as a result of the application of section 25B(2) be deemed to have been derived by D. Accordingly, S does not have a withholding responsibility under section 49E(1) at the date of payment.

As a result of the exercise of the trustees' discretion to vest the royalty in D on 28 February 2021, which is in the same year of assessment in which the royalty was received by Z Trust, section 25B(2) deems the royalty to have been derived by D.

Since the royalty is deemed to have accrued to a foreign person and it was paid by S to the trust on 31 January 2021, Z Trust is regarded as a withholding agent which has the responsibility for withholding any withholding tax on royalties at 15% from the payment of the royalty to D and paying it over to SARS by the end of the calendar month after the month in which vesting took place. In this example, since S has paid the royalty to the trust, the royalty has been paid for purposes of withholding tax on royalties (earlier payment and being due and payable) and the date of vesting is the date on which the trust must withhold withholding tax on royalties. Although the South African-sourced royalties are included in D's gross income, they are exempt from normal tax under section 10(1)(*l*).

Note:

1) If the royalty had accrued to the trust but had not been paid by S or become due and payable by the date the trustees exercised their discretion and vested the royalty in D, the royalty would not be "paid" for purposes of withholding tax on royalties. The trust's obligation to withhold withholding tax on royalties would then not be triggered on vesting but would be triggered only when S paid the royalty or it became due and payable.

2) If the trustees had exercised their discretion and vested the royalty in D after the end of Z Trust's year of assessment in which the royalty was received by or accrued to the trust, the trust would have been deemed to have derived the royalty [section 25B(1)] and not D. No withholding obligation would have arisen on payment of the royalty, since S would have paid the royalty to a resident. Z Trust would, however, have been required to include the royalty in its gross income.

The same principles discussed above for a resident discretionary trust apply to a foreign resident discretionary trust.

4.5 To the extent the amount is from a source within South Africa

Under section 49B(1)(*a*) the amount of any royalty that is paid to or for the benefit of a foreign person is liable to withholding tax on royalties to the extent it is regarded as having been received by or accrued to that foreign person from a source within South Africa under section 9(2)(*c*), (*d*), (*e*) and (*f*).

Under section 9(2)(*c*), (*d*), (*e*) and (*f*) an amount is received by or accrued to a person from a source within South Africa if it –

- constitutes a royalty[49] that is attributable to an amount incurred by a person that is a resident, unless the royalty is attributable to a permanent establishment[50] which is situated outside South Africa;
- constitutes a royalty[51] that is received by or accrues to the person for the use or right of use of or permission to use in South Africa any intellectual property as defined in section 23I;
- is attributable to an amount incurred by a person that is a resident and is received or accrues for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information, unless the amount received or accrued is attributable to a permanent establishment[52] which is situated outside South Africa; or
- is received by or accrues to the person for the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information for use in South Africa, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information.

A foreign person may receive royalty payments from a source within and outside South Africa. The "to the extent" wording in section 49B(1)(*a*) means that only the royalty from a source within South Africa will be liable to withholding tax on royalties. For example, an American franchising company might license its intellectual property to a franchisee based in South Africa as well as to franchisees based in other countries. Royalties will therefore be payable to the franchisor for the use of the intellectual property in South Africa and for use outside South Africa. In this scenario, only the royalty for the use of the intellectual property in South Africa will be liable to withholding tax under section 49B(1)(*a*), since the source of this income is within South Africa under the specified source rules. If a single payment was received or accrued from a source within and a source outside South Africa, an apportionment would be required.

4.6 Exemptions from withholding tax - section 49D

Section 49D provides that a foreign person will be exempt from withholding tax on royalties if –

- that person is a natural person who was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid (section 49D(*a*), see **4.6.1**);

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49 For the purposes of section 9, section 9(1) defines a royalty as "any amount that is received or accrued in respect of the use, right of use or permission to use any intellectual property as defined in section 23I".

50 This refers to a permanent establishment of the resident that incurred the expense.

51 For the purposes of section 9, section 9(1) defines a royalty as "any amount that is received or accrued in respect of the use, right of use or permission to use any intellectual property as defined in section 23I".

52 This refers to a permanent establishment of the resident that incurred the expense.

- the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa if that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act (section 49D(*b*), see **4.6.2**); or
- that royalty is paid by a headquarter company[53] for the granting of the use, right of use or permission to use intellectual property[54] to which section 31 does not apply as a result of the exclusions in section 31(5)(*c*) or (*d*) (section 49D(*c*), see **4.6.3**).

4.6.1 Foreign person is a natural person who was physically present in South Africa for a period exceeding 183 days

Section 49D(*a*) provides that a foreign person who is a natural person is exempt from withholding tax on royalties if that foreign person was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid.

At the same time, the foreign person would be subject to normal tax as a result of falling outside the exemption in section 10(1)(*l*). Under section 10(1)(*l*)(i) the exemption does not apply to a natural person who was physically present in South Africa for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty was received by or accrued to that person.

Meaning of "day"

In considering whether a foreign person has been physically present in South Africa for a period exceeding 183 days, the meaning of "day" needs to be considered. The word "day" is not defined in the Act and must therefore be given its ordinary dictionary meaning. A "day" is defined by *Lexico.com*[55] as follows:

> "1 A period of twenty-four-hour as a unit of time, reckoned from one midnight to the next, corresponding to a rotation of the earth on its axis."

Since a day consists of a continuous 24-hour period commencing at midnight, it excludes a part of a 24-hour period. The day of arrival and departure of a person are not considered when calculating the aggregate number of days because they will not comprise a continuous 24-hour period.

Determination of the 12-month period

Under section 1 of the Interpretation Act 33 of 1957 "month" means a calendar month. In this regard, Van der Westhuizen J stated the following in *Ex parte Minister of Social Development & others*:[56]

> "This Court has as yet not considered the computation of time or time periods. The general common-law rule is that, in the calculation of time the civilian method is applicable, unless a period of days is prescribed by law or contracting parties intended another method to be used.

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53 See section 1(1) and section 9I(1) for the definition of "headquarter company". For further information on headquarter companies in relation to withholding tax on royalties, see Interpretation Note 87 "Headquarter Companies" in paragraph 5.2.2.

54 As defined in section 23I.

55 **www.lexico.com/en/definition/day** [Accessed 22 April 2021].

56 *Ex parte Minister of Social Development & others* 2006 (4) SA 309 (CC) at 316.

> According to the civil computation method, a period of time expressed in months expires at the end of the day preceding the corresponding calendar day in the subsequent month. It is settled law that the commencement of a period of time in curial calculation is governed by the ordinary civilian method where any unit of time other than days is used.
>
> It follows, therefore, that 18 months from the date of judgment on 6 September 2004 ended at midnight on 5 March 2006."

Twelve-month period preceding the date on which the royalty is paid

Under section 49B(2) (see **4.3**) a royalty is deemed to be paid on the earlier of the date on which the royalty is paid or becomes due and payable.

The 12-month period concerned therefore ends on the day before the earlier of the date on which the royalty is paid or becomes due and payable. For example, if a royalty is due and payable on 1 January of year 2, the period of 12 months will run from 1 January of year 1 to 31 December of year 1.

Example 6 – Calculation of the 12-month period

Facts:

P, a foreign individual, granted Company X, a resident, a right to use P's registered copyright. The royalty is payable every six months on 1 July and 1 January. P regularly visits family in South Africa and has during the last 19 months been physically present in South Africa for the following periods:

June 2019	0 days
July 2019	0 days
August 2019	0 days
September 2019	0 days
October 2019	0 days
November 2019	28 days
December 2019	31 days
January 2020	31 days
February 2020	28 days
March 2020	0 days
April 2020	0 days
May 2020	0 days
June 2020	0 days
July 2020	0 days
August 2020	20 days
September 2020	30 days
October 2020	31 days
November 2020	30 days
December 2020	20 days

Result:

The 12-month period preceding the date on which the royalty was paid must be determined for each period for which the royalty is due and payable.

Royalty due and payable 1 July 2020

The 12-month period preceding the date on which the royalty was paid on 1 July 2020 for the 1 January 2020 to 30 June 2020 royalty, started on 1 July 2019 and ended on 30 June 2020. During this period P was physically present in South Africa for 118 days (28 + 31 + 31 + 28). Since P was physically present in South Africa for not more than 183 days, the exemption under section 49D(*a*) will not apply, resulting in the royalty payment being subject to withholding tax on royalties.

Royalty due and payable 1 January 2021

The 12-month period preceding the date on which the royalty was paid on 1 January 2021 for the 1 July 2020 to 31 December 2021 royalty, started on 1 January 2020 and ended on 31 December 2020. During this period P was physically present in South Africa for 190 days (31 + 28 + 20 + 30 + 31 + 30 + 20). Since P was physically present in South Africa for more than 183 days, the royalty paid on 1 January 2021 is exempt from withholding tax on royalties under section 49D(*a*).

4.6.2 Royalty effectively connected to a permanent establishment in South Africa and foreign person registered for tax

Under section 49D(*c*) a foreign person will be exempt from withholding tax on royalties if the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in South Africa and that foreign person is registered as a taxpayer under Chapter 3 of the Tax Administration Act.

The term “permanent establishment” is defined in section 1(1) to mean –

> “a permanent establishment as defined from time to time in Article 5 of the Model Tax Convention on Income and on Capital of the Organization for Economic Co-operation and Development: Provided that in determining whether a qualifying investor in relation to a partnership, trust or foreign partnership has a permanent establishment in the Republic, any act of that partnership, trust or foreign partnership in respect of any financial instrument must not be ascribed to that qualifying investor”.

Paragraph 1 of Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development, Condensed Version 21 November 2017 (OECD Model Tax Convention), defines “permanent establishment” as –

> “a fixed place of business through which the business of an enterprise is wholly or partly carried on”.

Paragraph 2 of Article 5 states that a “permanent establishment” includes –

> “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".

See Article 5(1) – 5(8) of the Model Tax Convention for more detail.

Paragraph 21 of the Commentary on Article 12 of the OECD Model Tax Convention dealing with Royalties, states that –

> "a particular location can only constitute a permanent establishment if a business is carried on therein and…that the requirement that a right or property be 'effectively connected' to such a location requires more than merely recording the right or property in the books of the permanent establishment for accounting purposes".

According to paragraph 21.1, a right or property in respect of which royalties are paid will be effectively connected to a permanent establishment if the economic ownership of that right or property is allocated to the permanent establishment. Such right or property will form part of the permanent establishment's business assets. The "economic" ownership of a right or property means the equivalent of ownership for income tax purposes of a separate enterprise, with the attendant benefits and burdens. For further guidance, see the report entitled *Attribution of Profits to Permanent Establishments*, OECD, Paris (2010).[57]

The circumstances of each case must be evaluated to determine whether intellectual property for which a royalty is paid is effectively connected to a permanent establishment.

A royalty received by or accrued to a foreign person from a source within South Africa which is effectively connected to that foreign person's permanent establishment in South Africa is subject to normal tax in the hands of that foreign person because the exemption in section 10(1)(*l*) is rendered inapplicable by the exclusion in section 10(1)(*l*)(ii). The latter exclusion applies when "the intellectual property or knowledge or information in respect of which that royalty is paid is effectively connected to a permanent establishment of that person in the Republic". The royalty received by the foreign person through a permanent establishment is thus taxed under the normal tax provisions and not the withholding tax on royalties provisions.

Example 7 – Intellectual property effectively connected to a permanent establishment

Facts:

A South African branch of a foreign company developed a patent in South Africa. The South African branch constitutes a permanent establishment.[58] All costs associated with the patent were paid out of the branch's bank account. The branch used the patent for business purposes in South Africa and also granted a right of use to South African companies. All royalty income from South African patent users was deposited in the branch bank account.

The foreign company is registered as a taxpayer in South Africa.

[57] The contents of this report are not examined in this Note but it can be accessed at **www.oecd.org/ctp/transfer-pricing/45689524.pdf** [Accessed 22 April 2021].

[58] Under paragraph 2(*b)* of Article 5 of the OECD Model Tax Convention, a permanent establishment includes a branch.

Result:

The branch actively uses the patent in South Africa because it is responsible for developing, registering and administering the patent, and has a right to the income attributable to the ownership of the intellectual property. The intellectual property is therefore effectively connected to the branch.

Although the royalty is paid to a foreign person, it is exempt from withholding tax on royalties under section 49D(*b),* because the intellectual property is effectively connected to the foreign company's permanent establishment in South Africa and the foreign company is a registered taxpayer in South Africa.

In relation to normal tax, under section 10(1)(*l*)(ii) the exemption in section 10(1)(*l*) does not apply because the property in respect of which the royalty is paid is effectively connected to the foreign company's permanent establishment in South Africa. The exclusion from the exemption means the royalties will be subject to normal tax.

4.6.3 Headquarter companies, section 31 and section 49D

A company that meets the requirements set out in section 9I may elect to be a headquarter company for a year of assessment. Included in the incentives available to headquarter companies[59] is the exemption from withholding tax under section 49D(*b*) on royalties paid to any foreign person for the use, right of use or permission to use intellectual property as defined in section 23I which are excluded from the transfer-pricing provisions in section 31 under section 31(5)(*c*) or (*d*).

Section 31 deals with the transfer pricing of specified international transactions.

Section 31(5)(*c*) stipulates that when a transaction, operation, scheme, agreement or understanding dealing with intellectual property as defined in section 23I(1) has been entered into between a person that is not resident and a headquarter company in which that person grants the use, right of use or permission to use that property to the headquarter company, section 31 will not apply to the extent that –

- the headquarter company grants the use, right of use or permission to use the intellectual property to a foreign company in which it directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10% of the equity shares and voting rights; and
- the headquarter company does not make use of that intellectual property other than granting the use, right to use or permission to use the property to that foreign company.

Section 31(5)(*d*) provides that section 31 will not apply when a transaction, operation, scheme, agreement or understanding dealing with intellectual property as defined in section 23I(1) has been entered into between a headquarter company and a foreign company –

- in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10% of the equity shares and voting rights; and

[59] See Interpretation Note 87 "Headquarter Companies".

- the headquarter company grants the use, right of use or permission to use that intellectual property to the foreign company.

If section 31 does not apply as provided for in section 31(5)(*c*) and (*d*), the exemption in section 49D(*c*) will apply.

4.7 Liability for the payer and the recipient of South African-source royalties

Broadly speaking, withholding tax on royalties must be levied on South African-source royalties paid to or for the benefit of a foreign person. The withholding tax on royalties system imposes liabilities on both the payer of the royalty and the foreign person that receives it or for whose benefit it is paid. Generally, the payer is required to withhold the tax from the royalty payment and to pay it to SARS and the foreign person is liable for the tax unless it has actually been paid over to SARS by someone else. These liabilities are considered below.

4.7.1 Liability for withholding tax on royalties

Section 49C(1) places the liability for withholding tax on royalties on the foreign person to whom or for whose benefit the royalty is paid, that is, actually paid or becomes due and payable (see **4.3**).

If the withholding tax on royalties has been withheld as required by the payer (see **4.7.2**) and paid over to SARS as required (see **4.11** – payment of the tax and the submission of a return are required), it will be regarded as being paid in respect of, and therefore discharging, the foreign person's liability for withholding tax on royalties.[60] The foreign person's liability for withholding tax on royalties will not be discharged if the withholding tax on royalties is withheld by the payer but not paid over to SARS.

4.7.2 Liability to withhold the tax

Although the liability for withholding tax on royalties is on the foreign person to whom or for whose benefit the royalty is paid (see **4.7.1**), an obligation to withhold the tax rests on the person making the payment of the royalty under section 49E(1). The term "paid" is defined as the earlier of payment or being due and payable (see **4.3**) and therefore withholding tax on royalties must be "withheld" on the earlier of the actual date of payment or when the royalty becomes due and payable.

Under section 156 of the TA Act this person is referred to as a withholding agent. A "withholding agent" means "a person who must under a tax Act withhold an amount of tax and pay it to SARS".

The person paying the royalty is thus obliged to withhold the withholding tax on royalties on the gross amount paid to or for the benefit of the foreign person (see **4.2** for an explanation of the rate and **4.9** for when a lower rate under a tax treat applies) unless an exemption applies (see **4.8**). The tax so withheld and paid over to SARS as required is regarded as a payment made on behalf of the foreign person.[61] The payer of the royalty must therefore ascertain the identity of the beneficial recipient of the royalty payment in order to be able to comply with the requirements of section 49E.

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[60] Section 49C(2).

[61] Section 49C(2).

Such an enquiry is particularly important when royalty payments are made to trustees or nominees holding investments on behalf of others.

A withholding agent will be personally liable for the withholding tax if that agent –[62]

- withholds an amount but does not pay it to SARS; or
- does not withhold an amount that should have been withheld.

If a withholding agent is held personally liable for an amount of tax as indicated above and the amount is paid to or recovered by SARS from the withholding agent, that amount is regarded as an amount of tax which is paid on behalf of the relevant taxpayer in respect of the taxpayer's liability under the relevant tax Act.[63]

Section 160(1) of the TA Act provides that a representative taxpayer, withholding agent or responsible third party that, as such, pays a tax is entitled –

- to recover the amount so paid from the person on whose behalf it is paid; or
- to retain out of money or assets in that person's possession or that may come to that person in that representative capacity, an amount equal to the amount so paid.

Unless otherwise provided for in a tax Act, a taxpayer on whose behalf an amount has been paid to the Commissioner by a withholding agent under a tax Act or by a responsible third party under section 179 of the TA Act, is not entitled to recover from the withholding agent or responsible third party the amount so paid. The person is, however, entitled to recover the amount of an unlawful or erroneous payment from SARS.

Example 8 – Liability to withhold the tax and calculation of the amount to be withheld

Facts:

X, a resident of Country Z, entered into an agreement with Y, a South African resident, allowing Y to make use of X's invention. According to the agreement, X is entitled to royalties from Y for the use of the patent rights relating to the invention. The royalties are payable on 31 January each year and are calculated at 5% of Y's turnover for each financial year ending on 31 December. For the year ended 31 December 2020, Y's turnover was R600 000. The royalty was paid on 31 January 2021 and Y withheld the withholding tax on royalties as required.

Result:

	R
Turnover for 2020	600 000
Royalties (R600 000 × 5%)	30 000
Withholding tax (R30 000 × 15%)	4 500

62 Section 157(1) of the TA Act.

63 Section 157(2) of the TA Act.

On 31 January 2021 when the royalty was paid, X is liable for withholding tax on royalties of R4 500. Y was therefore obliged to withhold this amount and pay it to the Commissioner by 28 February 2021. Y withheld the amount of R4 500 and therefore paid X R25 500 (R30 000 royalty − R4 500 withholding tax on royalty). If X pays over the amount of withholding tax on royalties as required to the Commissioner, the amount will be regarded as an amount paid by Y in respect of Y's liability under the Act.

4.8 Release from obligation to withhold tax

Under section 49E(2) no obligation to withhold tax will arise –

- to the extent that the royalty is exempt under section 49D(*c*) (see **4.6.3**); or
- if the foreign person to or for the benefit of which the payment of the royalty is to be made has submitted, before the royalty is paid, the following to the person making payment –
  - a declaration in such form as prescribed by the Commissioner (see **4.10**) that the person is exempt from withholding tax on the royalty payment under section 49D(*a*) or (*b*) (see **4.6.1** and **4.6.2**); and
  - a written undertaking in such form as prescribed by the Commissioner (see **4.10**) to forthwith inform the person making the payment in writing should the circumstances affecting the above-mentioned exemption change or should the royalty no longer be for the benefit of that foreign person.

The date of payment of the royalty is the earlier of payment or due and payable (see **4.3**).

With effect from 1 October 2020,[64] the declaration and written undertaking submitted to the person making payment will expire and be invalid after a period of five years from the date of the declaration.

A declaration and written undertaking may expire and be invalid before the automatic expiry after five years from the date of the declaration as referred to above. A declaration and written undertaking will also expire and be invalid as from the date that the foreign person's circumstances change and the information contained in the declaration or written undertaking is no longer accurate. For example, the foreign persons circumstances may change 12 months after giving the declaration such that they no longer meet the requirements in section 49D(*a*) or (*b*) for the exemption. In such a case, the declaration and undertaking expire and are invalid from the date the circumstances have changed and the information in the declaration or written undertaking is inaccurate.

Once a declaration and written undertaking have expired they will no longer meet the requirements for no withholding tax on royalties to be withheld (see above) and the full rate of 15% must be held unless a new and current declaration and written undertaking have been completed and submitted by the foreign person before the royalty is paid. For example, if a declaration and written undertaking were submitted by a foreign person on 1 January 2016 and a royalty is paid to the foreign person on 1 January 2021 without that foreign person having submitted a new declaration and written

64 Section 7(3) of Disaster Management Tax Relief Administration Act 14 of 2020.

undertaking, the person making payment must withhold withholding tax on royalties at the full rate of 15%.

In summary, if the declaration and written undertaking are not submitted before the royalty is paid or if the declaration and undertaking have expired and are therefore invalid, withholding tax on royalties must be withheld at the full rate of 15%. See **4.12** for details regarding the availability of a potential refund.

4.9 Reduction of the withholding rate

The rate at which withholding tax on royalties has to be withheld can potentially be reduced by an applicable tax treaty.

In ITC 1878, Vally J said that –[65]

> "the purpose of Double Taxation Agreements is to ensure that there is a free flow of trade and investment across countries, as well as a recognition that taxation is not avoided by the latitude afforded by the flow of free trade and investment. To achieve this purpose the two countries that are party to the Double Taxation Agreement agree that one of them will forego revenue. Which one ultimately does so depends on the facts regarding the business enterprise's operations as well as on the interpretation of the terms of the agreement concluded between the two countries".

Section 49E(3) provides that if a foreign person submits a declaration form declaring that an applicable tax treaty provides for a reduced rate of withholding tax on the royalty and a written undertaking (see below), to the person paying the royalty before the royalty is paid, the payer must withhold withholding tax on royalties at the reduced rate reflected in the declaration. For example, the rate of 15% in section 49B may be reduced to 5% or 10% by the treaty. The date of payment of the royalty is the earlier of the date of payment or the date on which it is due and payable (see **4.3**).

The declaration and the written undertaking must be in the form prescribed by the Commissioner (see **4.10**). In the written undertaking the person must undertake to inform the person making the payment in writing if the circumstances affecting the reduced rate change or if the payment of the royalty is no longer for the benefit of that foreign person.

With effect from 1 October 2020,[66] the declaration and written undertaking submitted to the person making payment will expire and be invalid after a period of five years from the date of the declaration.

See the last three paragraphs in **4.8** for commentary on the validity of a declaration and written undertaking which applies equally in the context of a reduction of the withholding rate.

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65 (2015) 77 SATC 349 (J) at 359.

66 Section 7(3) of Disaster Management Tax Relief Administration Act 14 of 2020.

4.10 Withholding Tax on Royalties Declaration form

One of the requirements under section 49E(2)(*b)* and (3), which deal with specified exclusions from the obligation to withhold withholding tax on royalties (see **4.8**) or to withhold at a reduced rate (see **4.9**), is that the declaration that must be submitted to the payer of the royalty must be "in such form as may be prescribed by the Commissioner". The form "Withholding Tax on Royalties Declaration (WTRD)" has been prescribed for this purpose and is available on the SARS website.

The form must be completed by the foreign person to or for the benefit of which the royalty is paid and submitted to the payer before the royalty is paid in order to give effect to –

- certain of the exemptions from the withholding tax (see **4.8**); or
- the reduced rate of tax (see **4.9**).

Failure to submit the form by the required date will result in the tax being withheld at the full rate of 15%.

The declaration form requires –

- particulars of the person making payment of the royalty;
- particulars of the foreign person;
- if an exemption is applicable, the reason why the foreign person is exempt from the withholding tax; and
- if a reduced rate of withholding tax is available, the number of the applicable article in the tax treaty between the contracting states and the reduced rate which is the applicable rate of tax under the tax treaty.

The form also includes an undertaking by the foreign person that the foreign person will inform the payer of the royalty in writing of any changes in the circumstances referred to in the declaration.

A new declaration will be required if there is a change in the foreign person's circumstances or if the payment is no longer for the benefit of the foreign person.

A change in circumstances may mean that an exemption or a reduced rate of tax no longer applies. Failure by the foreign person to inform the payer of the change in circumstances could result in an incorrect amount of withholding tax on royalties being withheld. The amount not withheld remains payable. Any underpayment may be subject to the imposition of interest and penalties.

In addition, with effect from 1 October 2020,[67] the declaration and written undertaking submitted to the person making payment will expire and be invalid after a period of five years from the date of the declaration.

[67] Section 7(3) of Disaster Management Tax Relief Administration Act 14 of 2020.

4.11 Payment of the withholding tax

The foreign person to whom or for whose benefit the royalty is paid, being the earlier of actually being paid or being due and payable (see **4.3**), is liable for the payment of the withholding tax on royalties. This person is obliged to make the payment by the last day of the month following the month during which the royalty is paid.[68] For example, if the royalty is paid to the foreign person in June 2020, the payment of the withholding tax on the royalty to SARS must be made no later than 31 July 2020.

The obligation on the foreign person to make payment of the withholding tax on royalties will, however, fall away if the tax has been paid by another person.[69] For example, if withholding tax on royalties has been withheld by the payer and paid over to SARS, the liability on the foreign person is discharged.

The person that withheld withholding tax on royalties under section 49E (see **4.7.2**) is obliged under section 49F(2) to submit a Return for Withholding Tax on Royalties (WTR01) and pay the tax to the Commissioner by the last day of the month following the month in which the royalty was paid, for example, by 31 July 2020 if the royalty was paid during June 2020. Payment of the royalty refers to the earlier of the date when the royalty was actually paid or became due and payable (see **4.3**).

A return must be completed for each amount of withholding tax on royalties that is withheld.

This return includes –

- details of the person paying the royalty;
- details of the foreign person;
- date of the royalty payment;
- gross amount of the royalty;
- applicable tax rate;
- amount of withholding tax payable; and
- interest payable on the withholding tax.

The total amount payable is equal to the withholding tax payable plus any interest. Interest will be payable by the withholding agent under section 89(2) if the withholding tax is not paid in full within the period allowed for payment.

For taxpayers that deal with the large Business Centre, the return must be submitted via email to **lbqueries@sars.gov.za** with proof of payment. All other taxpayers must manually submit the return at the nearest SARS branch office with proof of payment.

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68 Sections 49C and 49F(1).

69 Section 49F(1).

4.12 Refund of withholding tax on royalties

Section 49G enables a foreign person to obtain a refund of withholding tax under specified circumstances. The refunds available in section 49G override the refund procedures in Chapter 13[70] of the TA Act.

As stated in **4.10**, if a foreign person fails to submit the declaration form required under section 49E(2)(*b*) (see **4.8**) or 49E(3) (see **4.9**) before the royalty is paid, withholding tax on royalties must be levied and withheld at the full rate and not treated as not requiring a withholding or as requiring a withholding at a reduced rate to which the foreign person would have been entitled had the declaration form been submitted as required.

However, section 49G(1) provides that the amount of withholding tax in excess of the amount that would have been withheld had the declaration form been submitted as required is refundable to the foreign person to which the royalty was paid if –

- an amount is withheld from the payment of a royalty as required by section 49E(1);
- the declaration form referred to in section 49E(2) or (3) is not submitted to the person paying the royalty by the date of payment of the royalty; and
- the declaration form is submitted to the Commissioner within three years after the royalty to which the declaration relates is paid.

The calculation of a period expressed in weeks, months or years is done by the civil method of calculation.[71] The period so expressed will thus expire at the end of the day preceding the corresponding calendar day. If the royalty is, for example, paid on 15 July 2017, the three year period will lapse at the end of the day of 14 July 2020.

In practice the foreign person would usually submit the declaration form to the withholding agent together with a power of attorney within the three-year period. The withholding agent will then complete a REV16 form for refund claims and submit it together with the declaration form and a power of attorney to SARS. SARS will consider the claim and process it accordingly. As noted, the amount of any refund will usually be paid to the withholding agent and not directly to the recipient of the royalty.

Section 7(1)(*a*) of Disaster Management Tax Relief Administration Act 14 of 2020 provides that the period of lock down must not be taken into account when determining if the declaration form was submitted to the Commissioner within three years after the royalty to which the declaration relates is paid. The period of lockdown is defined in section 1 of that Act as the period between 23H59 on 26 March 2020 until 23H59 on 30 April 2020.

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70 This Chapter provides in section 190, for “Refunds of excess payments” and, in section 191, for “Refunds subject to set-off and deferrals.”

71 *Ex parte Minister of Social Development and others* 2006 (4) SA 309 (CC).

Example 9 – Refund of withholding tax

Facts:

A, a resident of Country X, entered into an agreement with B, a South African resident, which allowed B to make use of A's intellectual property. According to the agreement, A is entitled to royalties from B for the use of A's intellectual property. The payment of the royalties must be made by 31 January each year and is calculated at 4% of B's turnover. For the 12-month period ending 31 December 2018, B's turnover was R500 000. Article 12 of the tax treaty between Country X and South Africa provides for a reduced rate of taxation on royalties of 5% instead of 15%.

Payment of the royalty by B to A was made on 31 January 2019. On 15 July 2020, B, acting on A's behalf under a power of attorney, submitted the WTR declaration form pertaining to the royalty payment that was made on 31 January 2019 to the Commissioner.

Result:

a) B did not receive a WTR declaration form from A by 31 January 2019 when the royalty was paid and therefore B was not entitled to withhold a reduced rate of withholding tax on royalties under section 49E(3). Therefore, B correctly applied the rate of 15% and withheld and paid R3 000 (see below) to the Commissioner by 28 February 2019. The withholding tax was calculated as follows:

	R
Turnover for 2018	500 000
Royalties (R500 000 × 4%)	20 000
Withholding tax (R20 000 × 15%)	3 000

b) B submitted the WTR declaration form to the Commissioner on A's behalf within three years of the payment of the royalty. A refund of the excess amount of withholding tax on royalties that was withheld was thus permissible under section 49G.

	R
Turnover for 2018	500 000
Royalties (R500 000 × 4%)	20 000
Withholding tax (R20 000 × 5%)	1 000
Refundable amount = R2 000 (R3 000 – R1 000)	

Section 49G(1) deals only with refunds owing to a declaration under section 49E(2) or (3) not being submitted within the required time period. If withholding tax is incorrectly withheld and paid over to SARS (for example, the reduced rate in the declaration was incorrectly overstated or there was an error in the calculation of the amount) and a declaration form was submitted as required, a refund can potentially be claimed under section 190 of the TA Act if the requirements of that section are met.

In addition, section 49G(2) provides a mechanism for a refund to the extent withholding tax on royalties was paid on royalties that became due and payable and then subsequently became irrecoverable. The Commissioner is required to refund the withholding tax on royalties that was paid on the royalties that were due and payable

and subsequently became irrecoverable to the person who paid the tax under section 49G(2).[72]

4.13 Currency of payments made to the Commissioner

Section 49H provides that when an amount of withholding tax on royalties is withheld in the currency of a foreign country, the person making payment of the withholding tax to the Commissioner is obliged to translate the foreign currency into South African Rand at the spot rate on the date on which the amount is withheld. The spot rate is defined in section 1(1) as "the appropriate quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency".[73]

Example 10 – Translation of foreign currency

Facts:

XY, a resident of Country Z, entered into an agreement with AB, a South African resident, which allowed AB to make use of XY's intellectual property in return for a royalty of Z$2 000. The tax treaty between the two countries provides for a reduced rate of taxation of 5%. XY submitted the required declaration and undertaking to AB before the payment of the royalty.

On 1 March 2020, AB withheld an amount of Z$100. AB paid this amount to the Commissioner on 30 April 2020. The spot rate on 1 March 2020 was Z$1 = R10,0000 and on 30 April 2020, Z$1 = R10,5000

Result:

Under section 49H the amount to be paid to the Commissioner must be determined using the spot rate on the date on which the tax was withheld (1 March 2020). An amount of Z$100 × 10,0000 = R1 000 must therefore be paid to the Commissioner.

5. Other

5.1 The interaction between section 31 and Part IVA of the Act

The royalty withholding tax provisions in Part IVA of the Act are generally applicable to royalties actually paid, or which become due and payable, to or for the benefit of a foreign person.

Section 31(2), if applicable, requires that taxable income or tax payable of the person in whose hands the tax benefit results or will result must be calculated as if the terms and conditions of the affected transaction had been arm's length. It does not deem the underlying transaction to have been conducted at an adjusted amount for purposes of the Act as a whole and therefore does not alter the amount of the royalty paid or due and payable to the foreign person. Accordingly, any "adjustment" to taxable income or tax payable under section 31(2) will not impact on the amount of the royalty actually paid to the foreign person for purposes of withholding tax on royalties under Part IVA of the Act.

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[72] Tax Administration Laws Amendment Act, 24 of 2020.

[73] See Interpretation Note 63 "Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences Governed by Section 24I and the Eighth Schedule" for more information on spot rates and currency conversion.

In addition, section 31(3) is a secondary adjustment which also does not re-characterise or alter the amount of royalties paid or due and payable to the payee. For example, in a transaction falling within the ambit of section 31(2), Company A paid Company B, a foreign person, a royalty of R250 000. An arm's length amount of the royalty would have been R150 000. Accordingly, when calculating taxable income Company A claimed a deduction for R150 000. In addition, under section 31(3) the difference of R100 000 is deemed to be a dividend *in specie* declared and paid by Company A to Company B and Company A must consider possible dividends tax implications. Company B received a royalty of R250 000 which is subject to withholding tax on royalties. From Company B's perspective there is no impact of the reduced deduction which Company A was entitled to under section 31(2) or the deemed dividend under section 31(3) on the amount subject to withholding tax on royalties.

5.2 Duty to keep records

Section 29(1) of the TA Act requires a taxpayer to keep the records, books of account or documents that –

- enable the taxpayer to observe the requirements of a tax Act;
- are specifically required under a tax Act or by the Commissioner by public notice; and
- enable SARS to be satisfied that the person has observed these requirements.

The types of documents that would have to be retained would include, for example, the Withholding Tax on Royalties (WTR) Declaration form, intellectual property agreements between the contracting parties as well as any other document which would be relevant to the payment of royalties and withholding of tax on such royalties.

The records, books of account or other relevant documents must be retained –[74]

- in their original form in an orderly fashion and in a safe place;
- in a form, including electronic form, prescribed by the Commissioner by public notice; or
- in a form specifically authorised by a senior SARS official.

Under section 29(3) of the TA Act the records, books of account or documents must be retained by the taxpayer for a period of five years. Under section 32 of the TA Act, a taxpayer notified or aware of an audit or investigation or that has lodged an objection or appeal, must retain the relevant records, books of account or documents until the audit or investigation is concluded or the assessment or decision is final.

6. Conclusion

In summary:

- Sections 49A to 49H deal with withholding tax on royalties.
- In essence a royalty is an amount received or accrued for the use of intellectual property as defined in section 23I or for the imparting of scientific, technical, industrial or commercial knowledge or information as well as the rendering of assistance or service in connection with the application or use of such knowledge or information.

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[74] Section 30 of the TA Act.

- Withholding tax on royalties applies to royalties paid to or for the benefit of a foreign person from a South African-source. A foreign person means any person that is not a resident.
- Although the foreign person to whom a South African-source royalty is paid is liable for the payment of withholding tax on the royalties, the person paying the royalty is obliged to withhold the tax.
- Royalties are deemed for withholding tax purposes to be paid to a foreign person on the earlier of the date on which the royalty is paid or becomes due and payable.
- Withholding tax on royalties is levied at the rate of 15% on the gross amount of the royalty paid to the foreign person.
- The person withholding any withholding tax on royalties must submit a return and pay the tax over to SARS by the last day of the month following the month during which the royalty was paid.
- The foreign person also has an obligation to pay the tax over to SARS by the last day of the month following the month during which the royalty was paid, unless the tax has been paid by another person, for example, the person paying the royalty.
- Under section 49D a royalty payment to a foreign person may be exempt from withholding tax on royalties. The availability of some of the exemptions is subject to specific requirements being met.
- Section 49E(3) provides for withholding tax on royalties to be levied at a reduced rate in line with a tax treaty if there is an applicable treaty in place between South Africa and the country in which the foreign person is resident. The reduced rate applies only after the foreign person has submitted the prescribed declaration and undertaking to the payer.
- Withholding tax on royalties is refundable under specified circumstances under section 40G.
- Any amount of tax withheld under section 49E(1) denominated in a foreign currency must, for purposes of determining the amount to be paid to the Commissioner, be translated to rand at the spot rate on the date on which the amount was so withheld.

Leveraged Legal Products
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Annexure – The law

Section 1(1) – Definition of "resident"

"resident" means any—

(*a*) natural person who is—

(i) ordinarily resident in the Republic; or

(ii) not at any time during the relevant year of assessment ordinarily resident in the Republic, if that person was physically present in the Republic—

(*aa*) for a period or periods exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the five years of assessment preceding such year of assessment; and

(*bb*) for a period or periods exceeding 915 days in aggregate during those five preceding years of assessment,

in which case that person will be a resident with effect from the first day of that relevant year of assessment: Provided that—

(A) a day shall include a part of a day, but shall not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic through a "port of entry" as contemplated in section 9 (1) of the Immigration Act, 2002 (Act No. 13 of 2002), or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act; and

(B) where a person who is a resident in terms of this subparagraph is physically outside the Republic for a continuous period of at least 330 full days immediately after the day on which such person ceases to be physically present in the Republic, such person shall be deemed not to have been a resident from the day on which such person so ceased to be physically present in the Republic; or

(*b*) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic,

but does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation: Provided that where any person that is a resident ceases to be a resident during a year of assessment, that person must be regarded as not being a resident from the day on which that person ceases to be a resident: Provided further that in determining whether a person that is a foreign investment entity has its place of effective management in the Republic, no regard must be had to any activity that—

(*a*) constitutes—

(i) a financial service as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002); or

(ii) any service that is incidental to a financial service contemplated in subparagraph (i) where the incidental service is in respect of a financial product that is exempted from the provisions of that Act, as contemplated in section 1(2) of that Act; and

(*b*) is carried on by a financial service provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), in terms of a licence issued to that financial service provider under section 8 of that Act;

Sections 49A to 49H

PART IVA

Withholding tax on royalties

49A. Definitions.—In this Part—

"foreign person" means any person that is not a resident;

"royalty" means any amount that is received or accrues in respect of—

(*a*) the use or right of use of or permission to use any intellectual property as defined in section 23I; or

(*b*) the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or the undertaking to render any assistance or service in connection with the application or utilisation of such knowledge or information.

49B. Levy of withholding tax on royalties.—(1) (*a*) There must be levied for the benefit of the National Revenue Fund a tax, to be known as the withholding tax on royalties, calculated—

(i) at the rate of 15 per cent; or

(ii) at such rate as the Minister may announce in the national annual budget contemplated in section 27 (1) of the Public Finance Management Act, with effect from a date mentioned in that Announcement,

of the amount of any royalty that is paid by any person to or for the benefit of any foreign person to the extent that the amount is regarded as having been received by or accrued to that foreign person from a source within the Republic in terms of section 9 (2) (c), (d), (e) or (f).

(*b*) If the Minister makes an announcement contemplated in paragraph (a) (ii), that rate comes into effect on the date determined by the Minister in that announcement and continues to apply for a period of 12 months from that date subject to Parliament passing legislation giving effect to that announcement within that period of 12 months.

(2) For the purposes of this Part, a royalty is deemed to be paid on the earlier of the date on which the royalty is paid or becomes due and payable.

(3) The withholding tax on royalties is a final tax.

(4) Where a person making payment of a royalty to or for the benefit of a foreign person has withheld an amount as contemplated in section 49E(1), that person must, for the purposes of this Part, be deemed to have paid the amount so withheld to that foreign person.

49C. Liability for tax.—(1) A foreign person to which a royalty is paid is liable for the withholding tax on royalties to the extent that the royalty is regarded as having been received by or accrued to that foreign person from a source within the Republic in terms of section 9(2)(*c*), (*d*), (*e*) or (*f*).

(2) Any amount of withholding tax on royalties that is—

(*a*) withheld as contemplated in section 49E(1); and

(*b*) paid as contemplated in section 49F(1),

is a payment made on behalf of the foreign person to which the royalty is paid in respect of that foreign person's liability under subsection (1).

49D. Exemption from withholding tax on royalties.—A foreign person is exempt from the withholding tax on royalties if—

(*a*) that foreign person is a natural person who was physically present in the Republic for a period exceeding 183 days in aggregate during the twelve-month period preceding the date on which the royalty is paid; or

(*b*) the property in respect of which that royalty is paid is effectively connected with a permanent establishment of that foreign person in the Republic if that foreign person is registered as a taxpayer in terms of Chapter 3 of the Tax Administration Act; or

(*c*) that royalty is paid by a headquarter company in respect of the granting of the use or right of use of or permission to use intellectual property as defined in section 23I to which section 31 does not apply as a result of the exclusions contained in section 31 (5) (*c*) or (*d*).

49E. Withholding of withholding tax on royalties by payers of royalties.—(1) Subject to subsections (2) and (3), any person making payment of any amount of royalties to or for the benefit of a foreign person must withhold an amount of withholding tax on royalties from that payment.

(2) A person must not withhold any amount from any payment contemplated in subsection (1)—

(*a*) to the extent that the royalty is exempt from the withholding tax on royalties in terms of section 49D(*c*); or

(*b*) if the foreign person to or for the benefit of which that payment is to be made has, before the royalty is paid, submitted to the person making the payment—

(i) a declaration in such form as may be prescribed by the Commissioner that the foreign person is, in terms of section 49D (*a*) or (*b*), exempt from the withholding tax on royalties in respect of that payment; and

(ii) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the person making the payment in writing, should the circumstances affecting the exemption referred to in subparagraph (i) change or should the payment of the royalty no longer be for the benefit of that foreign person.

(3) The rate referred to in section 49B(1) must, for the purposes of that subsection, be reduced if the foreign person to or for the benefit of which the payment contemplated in that subsection is to be made has, before the royalty is paid, submitted to the person making the payment—

(*a*) a declaration in such form as may be prescribed by the Commissioner that the royalty is subject to that reduced rate of tax as a result of the application of an agreement for the avoidance of double taxation; and

(*b*) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the person making the payment in writing, should the circumstances affecting the application of the agreement referred to in paragraph (*a*) change or should the payment of the royalty no longer be for the benefit of that foreign person.

(4) A declaration and written undertaking submitted in terms of subsection (2) (*b*) or (3) are no longer valid after a period of five years from the date of the declaration.

49F. Payment and recovery of tax.—(1) If, in terms of section 49C, a foreign person is liable for any amount of withholding tax on royalties in respect of any amount of royalties that is paid to or for the benefit of the foreign person, that foreign person must pay that amount of withholding tax by the last day of the month following the month during which the royalty is paid, unless the tax has been paid by any other person.

(2) Any person that withholds any withholding tax on royalties in terms of section 49E must submit a return and pay the tax to the Commissioner by the last day of the month following the month during which the royalty is paid.

49G. Refund of withholding tax on royalties.—(1) Notwithstanding Chapter 13 of the Tax Administration Act, if—

(*a*) an amount is withheld from a payment of a royalty as contemplated in section 49E(1);

(*b*) a declaration contemplated in section 49E(2) or (3) in respect of that royalty is not submitted to the person paying that royalty by the date of the payment of that royalty; and

(*c*) a declaration contemplated in section 49E(2) or (3) is submitted to the Commissioner within three years after the payment of the royalty in respect of which the declaration is made,

so much of that amount as would not have been withheld had that declaration been submitted by the date contemplated in the relevant subsection is refundable by the Commissioner to the person to which the royalty was paid.

(2) Notwithstanding Chapter 13 of the Tax Administration Act, if—

(*a*) an amount of withholding tax on royalties is paid as contemplated in section 49E (1) in respect of an amount of royalties that became due and payable; and

(*b*) the amount of royalties subsequently becomes irrecoverable,

so much of that amount as would not have been paid had the royalties not become due and payable is refundable by the Commissioner to the person who paid the tax.

49H. Currency of payments made to Commissioner.—If an amount withheld by a person in terms of section 49E(1) is denominated in any currency other than the currency of the Republic, the amount so withheld must, for the purposes of determining the amount to be paid to the Commissioner in terms of section 49F(2), be translated to the currency of the Republic at the spot rate on the date on which the amount was so withheld.