SARS South African Revenue Service

BINDING GENERAL RULING (INCOME TAX): NO. 9 (Issue 2)

DATE: 19 February 2013

SUBJECT : TAXES ON INCOME AND SUBSTANTIALLY SIMILAR TAXES FOR PURPOSES OF SOUTH AFRICA'S TAX TREATIES

Preamble

For the purposes of this ruling –

- **"BGR"** means a binding general ruling issued under section 89 of the Tax Administration Act No. 28 of 2011;
- **"OECD"** means Organisation for Economic Co-operation and Development;
- **"section"** means a section of the Act;
- **"STC"** means secondary tax on companies;
- **"tax treaty"** means an agreement for the avoidance of double taxation;
- **"the Act"** means the Income Tax Act No. 58 of 1962; and
- **"treaty relief"** means relief from double taxation.

1. Purpose

This BGR –

- identifies the taxes administered by SARS, which in its opinion constitute taxes on income or substantially similar taxes for purposes of South Africa's tax treaties;
- provides specific commentary on the nature of the now-repealed STC and its replacement, dividends tax; and
- reflects SARS's view of the recognition of dividends tax as a covered tax under South Africa's tax treaties when it has been imposed after signature of a tax treaty.

2. Background

A tax treaty generally provides for relief for –

- specified taxes, usually listed under Article 2 of a tax treaty, that are in existence at the time the tax treaty is entered into; and
- any identical or substantially similar taxes on income that are imposed after the date of signature of the tax treaty in addition to, or in place of, existing specified taxes.

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3. Ruling

3.1 Taxes on income

The following taxes as at publication date of this BGR are taxes on income and thus qualify for treaty relief under South Africa's tax treaties:

- Normal tax on taxable income, which includes a taxable capital gain [section 5]
- Withholding tax on royalties, a final tax payable by non-residents on income derived from royalties or similar payments [section 35]
- Withholding tax on interest (effective 1 July 2013) [section 37J(1)]
- Tax on foreign entertainers and sportspersons, a final tax [section 47B(2)]
- Turnover tax on micro businesses [section 48A]
- STC (repealed 1 April 2012) [section 64B(2)]
- Dividends tax [section 64E(1)]

For purposes of the above list, the following are not taxes on income but represent advance payments of normal tax:

- Employees' tax [Fourth Schedule to the Act]
- Provisional tax [Fourth Schedule to the Act]
- Amounts withheld from payments to non-resident sellers of immovable property in South Africa [section 35A]

3.2 Treatment of STC

STC was repealed with effect from 1 April 2012 and has been replaced by dividends tax.

While STC was effective, corporate taxes on income were imposed at two stages.

Normal tax was (and still is) imposed at the first stage on an annual basis on corporate profits [or more accurately on "taxable income" as defined in section 1(1)].

STC was imposed at the second stage on a resident company on the "net amount" as described in section 64B(3) when a dividend was declared by the company. The net amount is the amount by which a dividend declared exceeds the sum of incoming dividends accrued during the "dividend cycle". A dividend cycle begins and ends each time a dividend is declared.

South Africa had reached agreement with all its treaty partners that STC was to be viewed as a creditable corporate tax. The circumstances under which a non-resident was able to secure a tax credit for STC was dependant on the terms of the tax legislation of the non-resident's country of residence.

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STC could result in economic double taxation, which involves two persons being subject to tax on the same amount. This would occur, for example, if a non-resident shareholder's country of residence imputed the profits of a South African company to that non-resident under a controlled foreign company system similar to that found in section 9D, or under a full imputation system for taxing foreign dividends,[1] and failed to provide a tax credit for the underlying corporate taxes. By granting a tax credit for the *pro-rata* portion of the underlying corporate income taxes (including STC) the non-resident's country of residence would prevent economic double taxation.

Since STC was not a tax on shareholders, it was not affected by any limitation imposed on the source state under the dividends article of South Africa's tax treaties. In *Volkswagen of South Africa (Pty) Ltd v C: SARS*[2] a South African-resident wholly owned subsidiary of a German holding company sought to obtain a rate of STC of 7,5% under Article 7 of the tax treaty with Germany. The court found that there are substantial differences between STC and a withholding tax, and STC was therefore not substantially similar to a withholding tax. STC is a tax on a company declaring a dividend and not a tax on the recipient shareholders. It is not a tax on dividends as contemplated in the tax treaty and accordingly fell outside the ambit of the article.

3.3 Dividends tax

Dividends tax came into effect on 1 April 2012 and replaced STC.

It is levied as a percentage of dividends paid by any company other than a headquarter company.

In the case of a dividend other than a dividend *in specie* the liability for the tax falls on the person entitled to the benefit of the dividend attaching to a share[3] (usually the shareholder) even though the tax is withheld by the company paying the dividend or by a regulated intermediary. Such a cash dividend falls within the dividends article of South Africa's tax treaties thus enabling a non-resident shareholder to secure a lower rate of dividends tax when applicable.[4]

The liability for dividends tax on a dividend *in specie* falls on the company paying the dividend.[5] In such event the tax is not a tax on the shareholder but a form of corporate tax similar to STC. Whether a non-resident shareholder will be able to secure a tax credit for dividends tax in these circumstances will depend on the system for taxing dividends in the non-resident's country of residence – the same principles that applied to STC will apply to dividends tax on a dividend *in specie*. Under section 64FA(2)(*a*) a company that distributes an asset in specie to a non-resident will be entitled to the lower rate specified in a tax treaty if the non-resident submits the required form to the company.

The question arises whether dividends tax is covered by South Africa's tax treaties even though it may not be specifically named as a covered tax.

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[1] Under a full imputation system for taxing dividends, the foreign dividend is grossed up to an amount equal to the proportionate share of the underlying pre-tax corporate profits.
[2] [2008] JOL 21746 (T), 70 SATC 195.
[3] Section 64EA(*a*).
[4] Article 10 of the OECD Model contains the dividends article. For a list of the tax treaty rates see "Dividends Tax – Summary of DTA rates" (version 3) dated 21 June 2012 available on the SARS website under Tax Types/Dividends Tax.
[5] Section 64EA(*b*).

Article 2 of the OECD Model Tax Convention on Income and on Capital (OECD Model) reads as follows:

"ARTICLE 2

TAXES COVERED

> 1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.
>
> 2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
>
> 3. The existing taxes to which the Convention shall apply are in particular:
>
> a) (in State A): ....
>
> b) (in State B): ....
>
> 4. The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws."

The United Nations Model Double Taxation Convention between Developed and Developing Countries (UN Model) includes a virtually identical article.

The OECD comments as follows on Article 2 of the OECD Model:[6]

> "3. This paragraph gives a definition of taxes on income and on capital. Such taxes comprise taxes on total income and on *elements of income*, on total capital and on elements of capital."

(Emphasis added.)

Dividends tax is a tax on an element of income.

Certain tax treaties do not contain paragraphs 1 and 2 of the OECD and UN Models but nevertheless contain a similar provision to paragraph 4. For example paragraph 2 of Article 2 of the tax treaty between South Africa and the United States of America reads as follows:

> "2. This Convention shall also apply to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their respective taxation laws or other laws affecting their obligations under the Convention, and of any official published material concerning the application of the Convention, including explanations, regulations, rulings, or judicial decisions."

The test of "identical or substantially similar taxes" is applied to the listed taxes of both Contracting States.

[6] Condensed version, 22 July 2010 at 75.

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The competent authority for South Africa has informed the competent authorities of all South Africa's treaty partners about the introduction of dividends tax into South African domestic law and has furnished them with the relevant information. This has been effected under the paragraph in Article 2 which pertains to a change in domestic tax law, thereby fulfilling the requirements stipulated in Article 2 and ensuring that dividends tax is viewed as a covered tax under South Africa's tax treaties.

This process will be repeated for the withholding tax on interest thus ensuring that it is also viewed as a covered tax under South Africa's tax treaties.

The competent authorities were also informed that dividends tax is similar to STC since it is also a tax on income. Consequently, it is considered to be a tax substantially similar to the taxes covered under Article 2 of the tax treaties.

3.4 Taxes which are not taxes on income or similar taxes

South African taxes as at the date of publication of this BGR which are not taxes on income or similar taxes, and thus do not qualify for treaty relief, include the following:

- Customs and excise duties
- Diamond export levy
- Donations tax[7]
- Estate duty
- Royalty levied on the transfer of a mineral resource extracted from within South Africa
- Securities transfer tax
- Skills development levy
- Transfer duty
- Unemployment insurance contributions
- Value-added tax

The above list is not exhaustive.

4. Period for which this ruling is valid

This BGR applies with effect from the date of publication and will apply for an indefinite period.

Group Executive: Interpretation and Rulings
Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
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[7] Under section 54 donations tax is only levied on a donation made by a resident. Consequently, donations tax will never be a creditable tax for tax treaty purposes.

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