

DRAFT INTERPRETATION NOTE

DATE:

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 31
SUBJECT : DEFINITION OF “ASSOCIATED ENTERPRISE”

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Preamble

In this Note unless the context indicates otherwise –

- **“Article”** means an Article of the OECD Model Tax Convention;
- **“OECD”** means the Organisation for Economic Co-operation and Development;
- **“OECD Model Tax Convention”** means the OECD Model Tax Convention on Income and on Capital, Condensed Version (as it read on 21 November 2017);
- **“resident”** means a resident as defined in section 1(1);
- **“section”** means a section of the Act;
- **“South Africa”** means the Republic of South Africa;
- **“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 interpretation notes 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 the definition of “associated enterprise” in section 31(1).

Section 66(1) of the Taxation Laws Amendment Act 20 of 2021 amended the effective date such that the inclusion of an “associated enterprise” in section 31 comes into operation on 1 January 2023 and applies in respect of years of assessment commencing on or after that date.

2. Background

The Act contains rules in section 31 which are aimed at preventing a reduction in the South African tax base as a result of the mispricing or incorrect characterisation of specified transactions, operations, schemes, agreements or understandings. Broadly, this is achieved by applying the arm’s length principle to affected transactions, as defined in section 31(1), and requiring the persons specified in section 31(2) to calculate their taxable income or tax payable as if transactions, operations, schemes, agreements or understandings had been entered into on terms and conditions that would have existed had the persons been independent persons dealing at arm’s length. In summary, affected transactions are transactions, operations, schemes, agreements or understandings directly or indirectly entered into or effected between or for the benefit of specified parties¹ that are connected persons² in relation to one another and that contain any terms or conditions that differ from those that would have existed had the parties been independent persons dealing at arm’s length.

The definition of “affected transaction” currently only includes transactions, operations, schemes, agreements or understandings directly or indirectly entered between the specified parties that are connected persons in relation to one another. As such, the application of the transfer pricing rules contained in section 31 have the unintended consequence of not always capturing transactions between “associated enterprises” which may not fall within the “connected persons” definition. To correct this unintended consequence and to bring the legislation in line with international standards, the term “associated enterprise” as contemplated in Article 9(1) has been inserted into section 31(1) and into the definition of an affected transaction with effect from years of assessment commencing on or after 1 January 2023.³ This will result in “affected transactions” applying to both associated enterprises and connected persons in respect of years of assessment commencing on or after this date.

3. The law

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

¹ See the definition of “affected transaction” in section 31(1) for detail.

² The definition of connected person is included in section 1(1) – see Interpretation Note 67 “Connected Persons” for a full consideration of connected persons.

³ Section 66(1) of the Taxation Laws Amendment Act 20 of 2021 amended section 37(1)(b) of the Taxation Laws Amendment Act 34 of 2019 such that the amendment comes into operation on 1 January 2023 and is applicable in respect of years of assessment commencing on or after that date.

4. Application of the law

4.1 “Affected transaction” and its relationship to connected persons and associated enterprises

The definition of “affected transaction”⁴ in section 31(1) contains two paragraphs:

- Paragraph (a) of the definition relates to the specified persons between which any transaction, operation, scheme, agreement or understanding must be entered, and
- Paragraph (b) of the definition relates to any term or condition that differs from any term or condition that would have existed if the persons had been independent persons dealing at arm’s length.

For a transaction, operation, scheme, agreement or understanding to be an “affected transaction”, both paragraph (a) and paragraph (b) must be met.

Paragraph (a) of the definition of “affected transaction” essentially means any transaction, operation, scheme, agreement or understanding directly or indirectly entered into or effected between or for the benefit of either or both –

- a resident and a non-resident;
- a non-resident and another non-resident that has a permanent establishment in South Africa to which the transaction, operation, scheme, agreement or understanding relates;
- a resident and another resident that has a permanent establishment outside South Africa to which the transaction, operation, scheme, agreement or understanding relates; and
- a non-resident and any other person that is a controlled foreign company in relation to any resident;

if those persons are connected persons or, in respect of years of assessment commencing on or after 1 January 2023, associated enterprises in relation to one another.

As mentioned above, paragraph (a) of the definition of “affected transaction” currently includes transactions, operations, schemes, agreements or understandings between specified persons that are connected persons in relation to one another and, for years of assessment commencing on or after 1 January 2023, between specified persons that are connected persons or associated enterprises in relation to one another. Depending on the facts, a person could be classified as a connected person, an associated enterprise or both a connected person and associated enterprise. In other words, connected persons and associated enterprises are not mutually exclusive.

In establishing the relationship between the specified persons, often one will practically first determine whether these parties are “connected persons” as defined. If the specified persons are not connected persons, it is then necessary to determine whether the parties nevertheless meet the wider definition of “associated enterprise”. In the event that the parties are found to be associated enterprises, the provisions of section 31 may apply, that is, there does not have to be a connected person relationship.

⁴ See the **Annexure** for the full definition of “affected transaction”.

4.2 Requirements pertaining to associated enterprises

An “associated enterprise” is defined in section 31 as “an associated enterprise as contemplated in Article 9 ...”.

Article 9 describes two enterprises as being “associated enterprises” where –

- an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or
- the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State.

Article 3 provides that “the term ‘enterprise’ applies to the carrying on of any business”.

For example, if one or more persons participates in the management of an enterprise of a Contracting State and the same person or persons participates in the management of an enterprise of the other Contracting State, the two enterprises are associated enterprises in relation to one another.

In the context of section 31, the use of “Contracting State” in the definition of “associated enterprise”, does not imply that in order for the definition to apply the two enterprises must have concluded an applicable double tax agreement. “Contracting State” and “other Contracting State” refers to different countries.

To be classified as an associated enterprise in relation to another enterprise, any of the three criteria, namely participation in management, participation in control or participation in capital must be met.

4.2.1 Direct or indirect participation in management

The term “management” is defined in the Cambridge Dictionary as ⁻⁵

“the control and organization of something...”

The term “management” is very broad and it is not possible to provide an exhaustive list of activities that do or do not constitute management. Instead, when assessing whether a particular person is managing a transaction, operation, scheme, agreement or understanding, it is necessary to consider all the facts of the particular case taking into account the activities for which the person is responsible, the person’s level of seniority and the scope of the person’s responsibilities in relation to influencing the terms or conditions of the transaction, operation, scheme, agreement or understanding especially the pricing.

Persons may be viewed as participating in the management of an entity if they participate in the appointment, dismissal or reassignment of the entity’s key management personnel, or if they share resources, or if direction in entering into significant transactions, operations, schemes, agreements or understandings exists.

Management often has decision making powers and that power is the ability to influence the operations of an entity. A person need not participate in the control or capital of an entity or entities to participate in the entity’s or entities’ management.

⁵ www.dictionary.cambridge.org/dictionary/english/management [Accessed 14 October 2022].

In assessing whether participation in management results in the parties to the transaction, operation, scheme, agreement or understanding being considered “associated enterprises”, for the purposes of section 31, the outcome of such participation in management must result in or have the consequence of controlling, effecting or influencing the terms or conditions, which includes pricing, of any transaction, operation, scheme, agreement or understanding, directly or indirectly entered into or effected between or for the benefit of either or both resident or non-resident party. This is relevant considering that there is no such control, effect or influence on the terms or conditions, including pricing, of a transaction, operation, scheme, agreement or understanding negotiated between independent parties that are acting in their own best interest. An assessment of whether participation in management resulted in or has the consequence of controlling, effecting or influencing the terms or conditions, including pricing, as mentioned above is very fact specific and can only be determined on a case-by-case basis.

An entity might be economically dependent on a single customer or supplier, leading to the customer or supplier having significant influence over the entity’s operation or a specific transaction, operation, scheme, agreement or understanding. This is not to say that the transfer pricing provisions apply to all transactions, operations, schemes, agreements or understandings between a party and a supplier or customer on which that party is economically dependent. There is a difference between an independent supplier or customer using their economic dominance to negotiate the best position for their own interest and a supplier or customer that crosses the line into participating in management and controlling, effecting or influencing the terms or conditions, including pricing, of transactions, operations, schemes, agreements or understandings. Whether or not the line is crossed must be determined on a case-by-case basis. For example, a major customer having the right of first refusal and influencing the price charged to any other customer buying the remaining products or the only supplier having the right to change pricing if the take up of material is lower than budgeted by the supplier, will often indicate participation in management resulting in the application of the transfer pricing provisions.

Example 1 – Same persons participate directly in the management of two companies

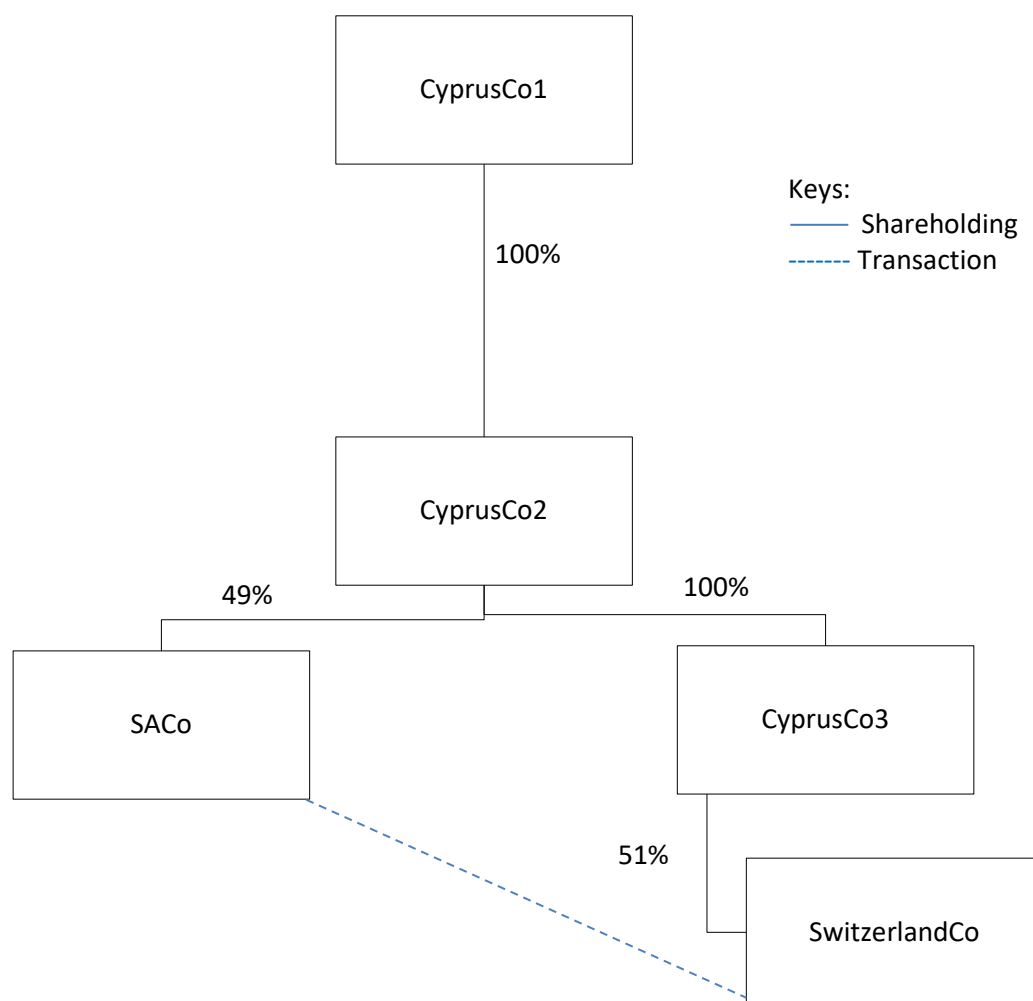
Facts:

CyprusCo2, a Cyprus resident entity, holds a 49% and 100% interest in SACo (a South African resident) and CyprusCo3 (a Cyprus resident) respectively. CyprusCo2 is the majority shareholder of SACo.

CyprusCo3 holds 51% interest in SwitzerlandCo, a Switzerland tax resident entity and SACo’s major customer.

SwitzerlandCo receives technical, management, financial and marketing services from CyprusCo2.

The diagram below provides a relevant extract of the group structure:



The SACo shareholders' agreement provides that the management and control of SACo lies with the board of directors and that the appointment of the management team and the board of directors is the sole responsibility of CyprusCo2. CyprusCo2 is also the sole advisor to SACo's CEO and CFO.

SwitzerlandCo's board of directors, CEO and CFO are appointed by CyprusCo2. CyprusCo2 is also the sole advisor to SwitzerlandCo's CEO and CFO.

SACo sells the majority of its goods to SwitzerlandCo. Goods sold by SACo to SwitzerlandCo are sold at a discount of 50% compared to sales to other customers. The pricing of all SACo's major sales transactions and purchase transactions is formally set by SACo's CFO, however the prices can only be set under the guidance and at the prices approved by its advisor (CyprusCo2). After setting the prices, the CFO tables the prices set to the board of directors for approval. Based on history, transaction pricing set by the CFO of SACo (under the guidance and approval of CyprusCo2) are guaranteed approval by the board of directors of SACo2.

Similarly, SwitzerlandCo's CFO approves the pricing for purchases from SACo based on the advice and approval of CyprusCo2.

Result:

The same person (CyprusCo2) participates directly in the management of SACo and SwitzerlandCo with an influence on pricing and accordingly SACo and SwitzerlandCo are associated enterprises in relation to each other. The participation in management by CyprusCo2 is evident in the role it plays in influencing the pricing of transactions between SACo and SwitzerlandCo which in turn is evident from the fact that:

- CyprusCo2 appoints the board of directors and management of both SACo and SwitzerlandCo2.
- CyprusCo2 is SACo's and SwitzerlandCo's advisor.
- SACo's CFO and SwitzerlandCo's CFO approve the pricing of transactions between SACo and SwitzerlandCo based on advice and at prices which have been approved by CyprusCo2.
- CyprusCo's influence is evident in the different prices applicable to transactions with SwitzerlandCo and other customers.
- The board of directors formally approve the prices, however evidence shows that the approval is in substance more of a notification process as the prices submitted are always approved by the SACo and SwitzerlandCo's respective board of directors.

Possible sources of information which confirm the associated enterprise relationship noted above may include:

- The shareholder agreement.
- Purchase/sale agreements.
- Minutes of the meeting of the board of directors.
- Employee input regarding the structure of the group and how it operates.

4.2.2 Direct or indirect participation in control

Generally, there are two types of control that exist when it comes to authority, *de facto* control and *de jure* control. *De facto* means a state of affairs that is true in fact, but that may or may not be officially sanctioned. In contrast, *de jure* means a state of affairs that is in accordance with law.⁶

The concept of control is related to the structure of decision-making within an entity with the relevant persons having the ability to and being involved in directing the strategic financing and operating policies of the entity.

In the context of the definition of an "associated enterprise", the type of control which is relevant is *de facto* control and relates to the ability of a person, and the exercise of that ability, to directly or indirectly materially influence the terms or conditions of the transaction, operation, scheme, agreement or understanding, especially the pricing. In the context of a company, *de facto* control is generally but not necessarily held and exercised by the board of directors of a company. However, the facts and circumstances of each case are critical in determining who is participating in the control of a company by influencing the terms or conditions of a transaction, operation, scheme, agreement or understanding, because the presence and influence of a

⁶ <https://onlinelaw.wustl.edu/blog/legal-english-de-factode-jure/> [Accessed 14 October 2022].

controlling person or persons can have a significant impact on the terms or conditions of a transaction, operation, scheme, agreement or understanding. For example, the board of directors of Company A could set the pricing for another company in the group (Company B), notwithstanding that Company B has its own board of directors consisting of different persons, with the result that Company A's board of directors are regarded as participating in the control of Company B. In another set of facts two companies may have one common director on the board of directors, that does or does not have any shareholding in either of the companies, which influences the pricing of both companies and is therefore regarded as participating in the control of both companies under the definition of an "associated enterprise". The facts and circumstances of each case are critical in determining *who has de facto control* because the presence and influence of controlling persons can have a significant impact on the terms or conditions.

Control may be obtained in many ways, such as the participation in the governing body by having the ability to appoint the board of directors, having a contract to administer the assets or liabilities of the entities, the ability to appoint management personnel, or dominating major contracts of the entity, and using that participation, contract or ability to influence the terms or conditions of the transaction, operation, scheme, agreement or understanding, especially the pricing.

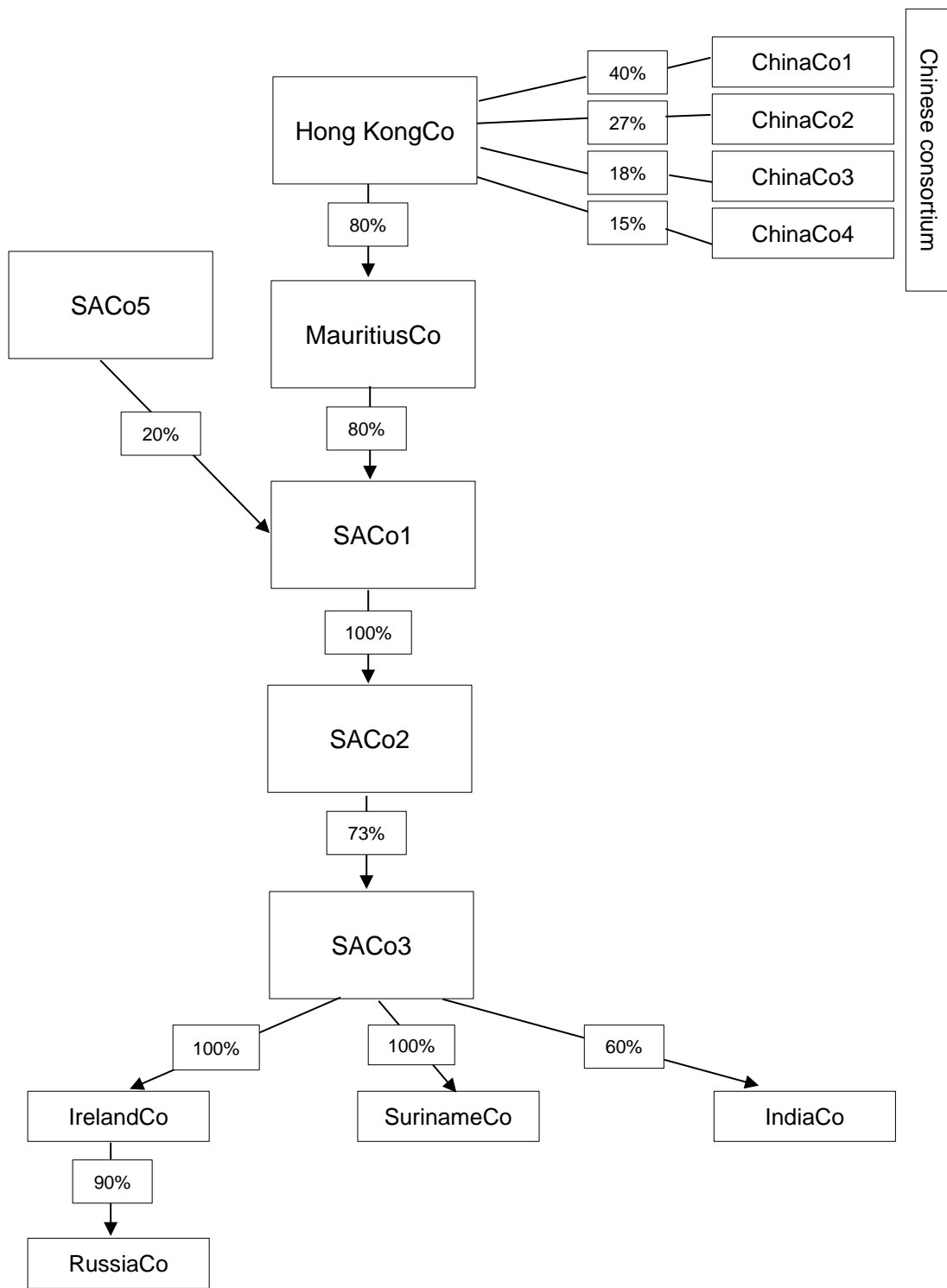
In assessing whether participation in control results in the parties to the transaction, operation, scheme, agreement or understanding being considered "associated enterprises" for the purposes of section 31, the outcome of the direct or indirect participation in control must result in or have the consequence of controlling, effecting or influencing the terms or conditions, including the pricing, of any transaction, operation, scheme, agreement or understanding, directly or indirectly entered into or effected between or for the benefit of either or both resident or non-resident party. This is relevant considering that there is no such control, effect or influence on the terms or conditions, including pricing, of a transaction, operation, scheme, agreement or understanding negotiated between independent parties that are acting in their own best interest. An assessment of whether participation in control resulted in or has the consequence of controlling, effecting or influencing the terms or conditions, including the pricing, as mentioned above is very fact specific and can only be determined on a case-by-case basis.

Example 2 – Same persons participate directly in the control of two companies

Facts:

SACo3 is a South African tax resident entity which is ultimately held by a Chinese Consortium. SACo3 sells all its export products to ChinaCo1 and ChinaCo2, members of the Consortium making up the majority of the Chinese Consortium's interest. Hong KongCo is a Chinese tax resident that sources customers and markets for SACo3's products in China, charging SACo3 a sales commission for its efforts. ChinaCo1 and ChinaCo2, with the assistance of Hong KongCo, is responsible for setting the pricing policy for the group.

The diagram below provides a relevant extract of the group structure:



SACo3 products are priced based on a listed price, however only ChinaCo1 and ChinaCo2 have an option for a discounted price based on their assessment of the “quality” of the products received. The discounts are considered unjustifiable as export sales are of a higher quality than local sales. ChinaCo1 and ChinaCo2 also require SACo3 to use Hong KongCo as its sales agent in selling the products to ChinaCo1 and ChinaCo2, resulting in sales commission payable to Hong KongCo.

Result:

ChinaCo1 and ChinaCo2 are associated enterprises in relation to SACo3 because ChinaCo1 and ChinaCo2 participate directly in the control of SACo3 in a manner which has a direct impact on the determination of the terms and conditions including pricing of the export sales between SACo3 and ChinaCo1, and SACo3 and ChinaCo2, respectively. This participation is evident in the following:

- The setting of the pricing policy for the group is the responsibility of ChinaCo1 and ChinaCo2 with assistance from Hong KongCo.
- ChinaCo1 and ChinaCo2 are the majority shareholders of Hong KongCo, ultimately being the majority shareholders of SACo3. ChinaCo1 and ChinaCo2 are the only export customers which means SACo3 inherently accepts operational and pricing related proposal and amendments from ChinaCo1 and ChinaCo2.
- All domestic sales by SACo3 to local independent parties are based on a listed price with no option of a discount or premium, whereas ChinaCo1 and ChinaCo2 have the option of a discounted price based on their assessment of and dissatisfaction with the quality of the product.
- ChinaCo1 and ChinaCo2 also require that SACo3 pays a sales commission to Hong KongCo for its export sales even though SACo3 may only sell its export product to ChinaCo1 and ChinaCo2 in terms of a pre-established agreement.

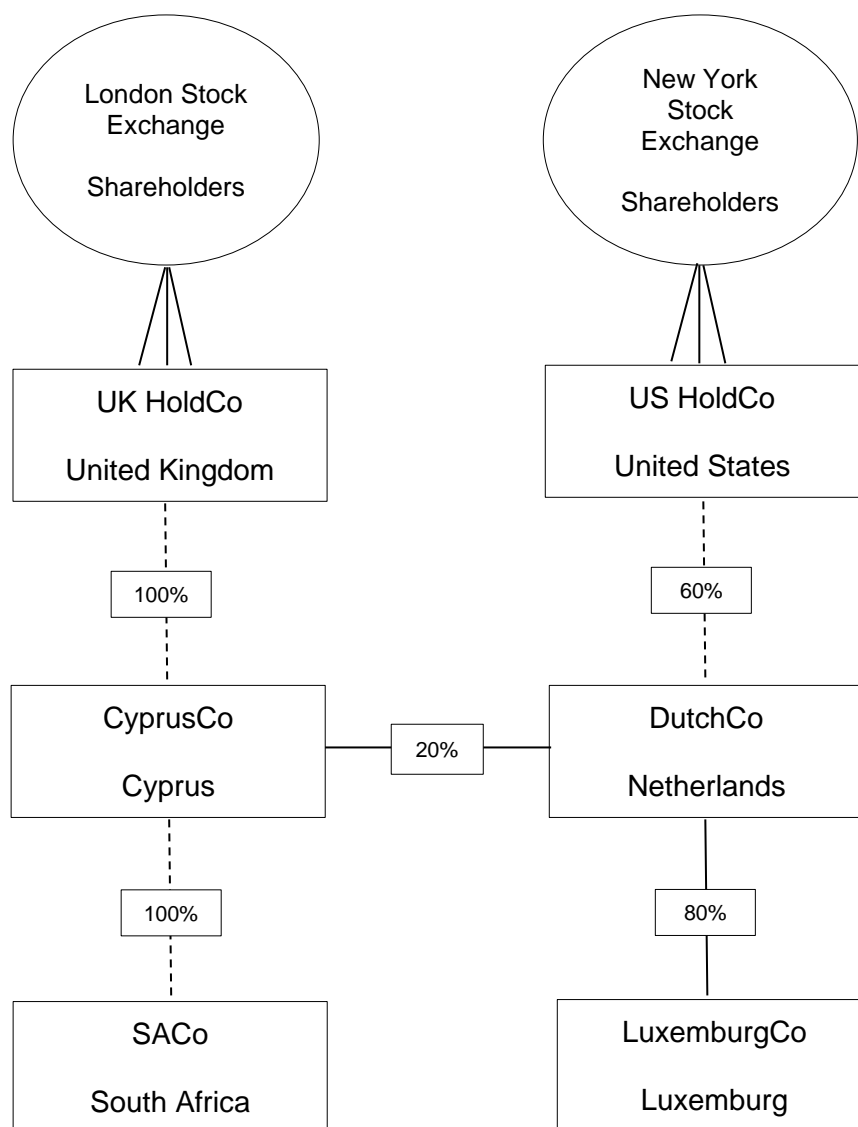
Possible sources of information which confirm the associated enterprise relationship noted above may include:

- Sales agreements.
- Minutes of the meeting of the board of directors.
- Transfer Pricing policy for the group.
- Price determination and relevant financial analysis.
- Employee input regarding the structure of the group and how it operates.

Example 3 – Same persons participate indirectly in the management, control or capital of both resident and non-resident entities*Facts:*

SACo is a South African tax resident entity. SACo sold products to LuxembourgCo, a company incorporated and tax resident in Luxembourg. LuxembourgCo is a worldwide marketing and distribution company for the Distribution group (which includes all the companies on the diagram below).

The diagram below provides for a relevant extract of the group structure:



----- Indirect shareholding

———— Direct shareholding

SACo and LuxembourgCo are subsidiaries of two different ultimate holding companies, namely UK HoldCo and US HoldCo, that are not connected persons in relation to one another.

Both UK HoldCo and US HoldCo have entered into a Dual Listed Company arrangement. In terms of this arrangement:

- (i) the two companies operate as a single unified economic entity, through Boards of Directors that comprised of the same individuals and a unified senior executive management team which is involved in setting the price for goods sold to LuxembourgCo by SACo.

- (ii) certain equalisation principles were to be observed, which ensured the economic and voting interests in the combined Distribution Group resulting from the holding of one US HoldCo share were equivalent to that resulting from one UK HoldCo share.

Pricing for the Distribution Group is managed and controlled by the unified senior executive management team operating for UK HoldCo and US HoldCo., through a centralised pricing policy for the group that each member of the group must adhere to for transactions entered into between one another.

Result:

SACo and LuxembourgCo are associated enterprises in relation to each other because the same persons in the form of the senior executive management team participate indirectly in the management of SACo and LuxembourgCo in a manner which has a direct impact on the determination of the terms and conditions which includes pricing of the export sales between SACo and LuxembourgCo. The fact that the same persons in the form of the Board of directors for the ultimate holding entities, US HoldCo and UK HoldCo, participate indirectly in the management and the control of both SACo and LuxembourgCo in a way which influences the terms and conditions such as the price determination of transactions entered into between SACo and LuxembourgCo, is another reason why SACo and LuxembourgCo are associated enterprises in relation to each other.

This above-mentioned participation is evident in that both ultimate holding entities –

- operate as a unified economic entity;
- have boards of directors comprised of the same individuals;
- comprise of the same unified senior executive management involved in price setting for the sale and purchases of goods for all companies in the Distribution Group; and
- have equal economic and voting interest in the Distribution Group.

Possible sources of information which confirm the associated enterprise relationship noted above may include:

- The dual listing company agreement.
- The board meeting attendance registers of both entities identifying individuals serving in both entities at the same time.
- List of employees from the payroll.
- Board minutes and pack or minutes and packs of other Board or operational committees within the group.
- Pricing policies of the group and those specifically applied by LuxembourgCo and SACo.
- Transfer pricing documentation for the group or specifically for SACo and LuxembourgCo.

- Any other document indicating possible influence over the terms and conditions of the transaction, including the pricing, as result of the participation in management or control of LuxembourgCo and SACo.
- Employee input regarding the structure of the group and how it operates.

4.2.3 Direct or indirect participation in capital

Direct or indirect participation in the capital of an entity refers to the direct or indirect beneficial ownership of shares or voting rights in an entity. In assessing whether participation in capital results in the parties to the transaction, operation, scheme, agreement or understanding being considered “associated enterprises” for the purposes of section 31, the outcome of the direct or indirect participation in capital must result in or have the consequence of controlling, effecting or influencing the terms or conditions, which includes the pricing, of any transaction, operation, scheme, agreement or understanding, directly or indirectly entered into or effected between or for the benefit of either or both resident or non-resident party. This is relevant considering that there is no such control, effect or influence on the terms or conditions of a transaction, operation, scheme, agreement or understanding, negotiated between independent parties that are acting in their own best interest. An assessment of whether participation in capital resulted in or has the consequence of controlling, effecting or influencing the terms or conditions, including the pricing, as mentioned above is very fact specific and can only be determined on a case-by-case basis.

Generally, shareholders with sufficient shares or voting rights are capable of influencing the decisions of an entity’s operations. This influence can be exercised through shareholders meetings during which shareholders debate with each other and vote on resolutions put forward to them.

Article 9 refers to a participation in capital without specifying a percentage holding of shares or voting rights which would be regarded as participation having an ability to sufficiently influence terms or conditions, including the pricing, for purposes of transfer pricing. Therefore, a facts and circumstances test applies. Generally speaking, if the holding of shares or voting rights is very low it is unlikely to indicate an ability to influence the terms or conditions. It is anticipated that it is unlikely that the percentages relating to the holding of equity shares or voting rights which are below those specified in the definition of “connected person” will result in a participation in capital that results in or has the consequence of controlling, effecting or influencing the terms or conditions of any transaction, operation, scheme, agreement or understanding. See paragraph (iv) of the definition of “connected person” section 1(1) for an example of the percentages specified.⁷

However, although shareholding or voting right percentages which are below that specified in the connected person definition in the appropriate circumstances are unlikely to result in a person being an “associated enterprise”, the test to determine whether a person participates directly or indirectly in the capital of another person, or the same person directly or indirectly participates in the capital of two entities, at a level sufficient to influence the terms or conditions remains a facts and circumstances test. Accordingly, if the facts demonstrate that notwithstanding, for example, a low shareholding or voting percentage, a shareholder influences the terms and conditions,

⁷ See Interpretation Note 67 “Connected Persons” for commentary on the definition of “connected person”.

including the pricing of a transaction, operation, scheme, agreement or understanding then the criteria of “participation in capital” will be met.

5. Conclusion

Broadly, section 31 deals with the tax payable by persons in respect of international transactions, operations, schemes, agreements or understandings and requires such transactions, operation, scheme, agreement or understanding to be based on the arm’s length principle. Prior to the amendment of this section which included a definition of “associated enterprise” and included that term in the definition of “affected transaction”, section 31 and the definition of “affected transaction” only covered connected persons.

The exclusion of associated enterprises from section 31 effectively created a potential anomaly and unfair reduction in the tax base. As such, the “associated enterprise” definition was inserted in section 31 in order to correct this potential irregularity.

Leveraged Legal Products
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Annexure – The law**Section 31**

31. Tax payable in respect of international transactions to be based on arm's length principle.—(1) For the purposes of this section—

“**affected transaction**” means any transaction, operation, scheme, agreement or understanding where—

- (a) that transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both—
 - (i) (aa) a person that is a resident; and
(bb) any other person that is not a resident;
 - (ii) (aa) a person that is not a resident; and
(bb) any other person that is not a resident that has a permanent establishment in the Republic to which the transaction, operation, scheme, agreement or understanding relates;
 - (iii) (aa) a person that is a resident; and
(bb) any other person that is a resident that has a permanent establishment outside the Republic to which the transaction, operation, scheme, agreement or understanding relates; or
 - (iv) (aa) a person that is not a resident; and
(bb) any other person that is a controlled foreign company in relation to any resident,

and those persons are connected persons or associated enterprises⁸ in relation to one another; and

- (b) any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length;

“**associated enterprise**” means an associated enterprise as contemplated in article 9 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development

Article 3(1)(c) of the OECD Model Tax Convention

c) the term “enterprise” applies to the carrying on of any business;

⁸ Associated enterprise is effective for years of assessment commencing on or after 1 January 2023.

Article 9 of the OECD Model Tax Convention

1. Where:

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make such an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Agreement and the competent authorities of the Contracting States shall if necessary consult each other.