REPORTABLE

IN THE TAX COURT OF SOUTH AFRICA
HELD AT BLOEMFONTEIN

Case No.: 12158

In the case between:

Appellant

and

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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JUDGEMENT: VAN DER MERWE, J

HEARD ON: 22 MARCH 2007

DELIVERED ON: 8 MAY 2007

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[1] This is an appeal by the appellant in terms of section 83(1) of the Income Tax Act, No. 58 of 1962 ("the Act") against the assessments of the respondent ("the Commissioner") for the 2002 and 2003 tax years. The matter was initially referred to a tax board, which ruled in favour of the appellant. As the Commissioner is dissatisfied with the decision of the board, the appeal was referred to this Court, to be heard *de novo* in terms of section 83A(14) of the Act.

[2] All the facts of the matter material for the decision of the appeal were commendably dealt with by the parties and are therefore common cause. Virtually all the facts contained in the record of the appeal are undisputed or common cause. In addition a statement of agreed facts was handed in by agreement between the parties. In the result, no evidence was led by either party.

[3] The appellant resides permanently in the Republic of South Africa. The appellant is an attorney, admitted to practice as such in both South Africa and the Kingdom of Lesotho. The appellant is a partner of both the firm A in B and the firm C in D. The firm of attorneys D in Lesotho is a partnership in terms of a written agreement. As such C is registered in the Deeds Registry in Lesotho. C does business only in Lesotho from a permanent establishment in Lesotho. The partners of C are citizens or permanent residents of either Lesotho or South Africa. When rendering services as attorneys, the partners do not act individually but act on behalf of C. The client is billed for such services by C and payment is received from the client by C. Profits of the partnership so derived, are shared

equally by the partners. C is registered in Lesotho as a tax entity and is required to file a partnership return. However the profits of the partnership are taxed in Lesotho in the hands of the individual partners. The profits earned by the appellant in Lesotho as a partner of C for the tax years 2002 and 2003 were thus taxed in Lesotho. However, in his assessments for these tax years, the Commissioner included these profits in the appellant's taxable income, but credited the appellant with the amounts of tax paid thereon in Lesotho.

[4] The case of the appellant in essence is that his share of the profits of C is taxable only in Lesotho and exempted from tax in South Africa. In this regard the starting point is that South Africa has a residency based system of taxation. All income, wherever earned, are included in the definition of gross income contained in the Act. This may result in double taxation for instance in respect of income earned in a country with a source based system of taxation. In terms of section 108 of the Act, the national executive may enter into an agreement with the government of any other country whereby *inter alia* arrangements are made with

such government with a view to the prevention, mitigation or discontinuance of the levying of tax in respect of the same income, profits or gains. Accordingly the governments of the Republic of South Africa and the Kingdom of Lesotho entered into an agreement entitled "AGREEMENT BETWEEN THE GOVERNMENT OF THE REPUBLIC OF SOUTH AFRICA AND THE GOVERNMENT OF THE KINGDOM OF LESOTHO FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME" ("the DTA"). The DTA was published under Government Notice 607 in Government Gazette 17948 of 22 April 1997 and the arrangements contained therein thus have effect as if enacted in the Act, in terms of section 108(2) of the Act. The DTA provides for the avoidance or alleviation of double taxation by way of exemption, foreign tax credit or deduction in respect of every conceivable form of income, including, in article 7, business profits and in article 14, income derived from independent personal services.

[5] However, in terms of article 1 thereof, the DTA applies only to persons who are residents of one or both of the Contracting States. In terms of article 3 of the DTA, the terms “a Contracting State” and “the other Contracting State” mean Lesotho or South Africa as the context requires. The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State. The term “person” includes an individual, a company and any other body of persons which is treated as an entity for tax purposes.

[6] Article 4 of the DTA deals with the important term “resident of a Contracting State”. It is clear from the provisions in respect thereof as a whole, that for purposes of the DTA any person must be regarded as a resident of only one of the Contracting States. The term “resident of a Contracting State” means in Lesotho, any person, who under the laws of Lesotho, is liable to tax therein by reason of his residence, place of management or any other criterion of a similar nature. This term means in South Africa, any

individual who is ordinarily resident in South Africa and any other person which has its place of effective management in South Africa. It is common cause that by reason of his permanent residence in South Africa, the appellant is a resident of the Contracting State, South Africa. It is accordingly unnecessary to refer to the provisions of article 4 of the DTA determining the status of a person to which both the aforesaid definitions might apply.

[7] For its aforesaid contention that the profits of C are taxable only in Lesotho, the appellant relies on the provisions of article 7.1. Article 7.1 provides as follows:

> "1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment."

[8] In my judgement the appellant's contention is unacceptable. As appears from what is stated above, an enterprise of a Contracting State means an enterprise carried on by a resident of a Contracting State. A resident of a Contracting State in Lesotho is a person who is liable to tax in Lesotho. The appellant's proposition therefore is dependent on whether C is liable to tax in Lesotho. This the appellant did not prove. On the contrary, the appellant expressly accepts that C, although registered as a tax entity, is not liable to tax in Lesotho. The position in respect of partnerships in Lesotho would appear to be similar to the position provided for in respect of partnerships by the Act. The Act provides in section 66 (15) that persons carrying on any business in partnership shall make a joint return of partners in respect of such business but in terms of section 77(7) that separate assessments shall notwithstanding be made upon partners. In fact, as will be shown presently, a proper application of article 7.1 leads to precisely the opposite conclusion than that put forward by the appellant.

[9] In support of the assessments in question, the Commissioner relied on the provision of article 14 of the DTA. This article provides the following:

> "1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character may be taxed in the other Contracting State only to the extent that the services were rendered in that other State, unless he has a fixed base regularly available to him in that other State for the purpose of performing his activities. If he has such a fixed base, the income which is attributable to that fixed base may be taxed in that other State.
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> 2. The term "professional services" includes independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants or other professional persons."

[10] I cannot agree with this position. In the statement of agreed facts it is expressly stated that what the appellant derived from C in each of the years of assessment in question, was a share in profits. This amounts to an admission made on behalf of the Commissioner. This

admission is abundantly shown to be correct by the admitted and undisputed documentation forming part of the record. An equal share in the total profit (i.e. total income not consisting only of fees less total expenses) of C for each year in question was credited to each partner, including the appellant. The calculation of the taxable amounts in question did not involve individual fees of the appellant. In short, we are not dealing with income derived from independent activities. I therefore find that article 14 of the DTA is not applicable to this case, although I agree that if it was, it would have produced the same result of the appeal.

[11] On the other hand article 7 of the DTA deals specifically with the profits of an enterprise. In my view the appellant carries on an enterprise in respect of C in Lesotho, together with others. This is placed beyond doubt by section 24H(2) of the Act which provides that where any trade or business is carried on in partnership, each member of such partnership shall be deemed for the purposes of the Act to be carrying on such trade or business. As the appellant is a resident of South Africa, the appellant's involvement in C

is an enterprise of South Africa that carries on business in the other Contracting State (Lesotho) through a permanent establishment therein. Therefor, in terms of article 7, the profits of the enterprise so carried on by the appellant may be taxed in Lesotho, but taxes so paid should be deducted from taxes due by the appellant in South Africa, in terms of article 22 of the DTA, as was done by the Commissioner.

[12] It follows that the assessments in question cannot be disturbed.

[13] For these reasons the appeal is dismissed and the assessments confirmed.

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C. H. G. VAN DER MERWE, J
PRESIDENT

I concur**.**

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A. J. KOCH
MEMBER

I concur.

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D. J. SMIT
MEMBER

On behalf of the appellant:	D. P. Molyneaux Instructed by: Webbers BLOEMFONTEIN
On behalf of the respondent:	E. Vögel

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