

THE RELATIONSHIP BETWEEN DOUBLE TAXATION AGREEMENTS AND THE PROVISIONS OF THE SOUTH AFRICAN INCOME TAX ACT

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Abstract

This article investigates the legal status of Double Taxation Agreements, and the relationship between Double Taxation Agreements, which are concluded in terms of section 108 of the Income Tax Act, and the provisions of the Income Tax Act (taking into account the provisions of the Constitution, and the national and international rules for the interpretation of statutes). An important conclusion reached was that as the Vienna Convention on the Law of Treaties represents customary international law and as such forms part of South African law, the principles contained in the treaty should be taken into account when interpreting South African legislation (including Double Taxation Agreements). The final conclusion of the research was that Double Taxation Agreements have a dual nature – forming part of domestic legislation and being classified as international agreements. The provisions of the Double Taxation Agreement should be taken as overriding any conflicting legislation in the Income Tax Act.

Keywords

Double Taxation Agreement, DTA, South African Income Tax Act, Constitution of South Africa, Vienna Convention on the Law of Treaties

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1. INTRODUCTION

As the calculation of a person's liability for income tax in South Africa begins with gross income, it is essential to determine whether or not an amount should be included in the person's gross income. Section 1 of the Income Tax Act no 58 of 1962, as amended (hereinafter referred to as "the Income Tax Act"), defines gross income as meaning:

- (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
- (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period...

The definition of gross income in section 1 of the Income Tax Act stipulates that South Africa may impose tax on a resident on amounts received or accrued from all sources and on a person other than a resident in respect of amounts received or accrued or deemed to have been received or accrued from a South African source (subject to certain special provisions in the Income Tax Act).

An amount received by or accrued to a non-resident may be subject to tax in South Africa in terms of the South African source rules, while also being subject to tax in the country of residence of the taxpayer. The converse situation may also arise, that is, an amount may be received by or accrued to a South African resident taxpayer from a source outside South Africa, which is subject to tax in the other country in terms of that country's tax legislation, while also being subject to tax in South Africa as a result of the taxpayer's residence in South Africa. Section 108 of the Income Tax Act, read in conjunction with section 231(4) of the Constitution of South Africa, 1996 (hereinafter referred to as the "Constitution"), provides for the prevention of or relief from such double taxation by enabling the National Executive to enter into an agreement with the government of any other country. South Africa has entered into such Double Taxation Agreements (referred to as "DTAs") with more than seventy countries (including most of its major trading partners) for purposes of the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. DTAs, however, do not create taxing rights, but merely allocate taxing rights to the country in question. It is only the Income Tax Act that is able to impose an income tax liability in South Africa.

As the DTAs affect South Africa's right to impose tax on both resident and non-resident persons, an understanding of DTAs (and how the DTAs should be interpreted in the context of the South African Income Tax Act) is essential when evaluating the income tax implications of international transactions.

The primary question that this article addresses is whether preference should be given to the provisions of the Income Tax Act or to the provisions of a DTA in cases of conflict. The answer to this question is significant, as it has a material impact upon South Africa's right to tax international transactions. In 2012 the Supreme Court of Appeal issued a judgment in *Commissioner for South African Revenue Services v Tradehold Ltd*, which stated that the provisions of a DTA modify domestic law and 'will apply in preference to domestic law'. This judgment is in conflict with the 2003 judgement of the Supreme Court of Appeal in *AM Moola Group Ltd and Others v C:SARS*, which stated that where there is a conflict between the Customs and Excise Act and a trade agreement, the provisions of the Act should take preference. While the *Commissioner for South African Revenue Services v Tradehold Ltd* judgement dealt with

Income Tax and the *AM Moola Group Ltd and Others v C:SARS* judgement dealt with Customs and Excise, the conflicting judgments of the Supreme Court of Appeal indicate a lack of certainty with regard to the legal status of international agreements (including DTAs) in South Africa. It is consequently submitted that there is a need for a clear theoretical argument setting out whether preference should be given to the provisions in a DTA or to the provisions in the Income Tax Act (and why).

A second question, which is addressed in this article, is the significance of the provisions of the Vienna Convention on the Law of Treaties in South African law. It is submitted that the answer to this question is relevant, as it impacts upon the interpretation of a large number of international agreements and conventions in South Africa.

2. RESEARCH OBJECTIVE

The goal of the research is to investigate the legal status of DTAs in South Africa, and to investigate the relationship between DTAs, which are concluded in terms of section 108 of the Income Tax Act, and the provisions of the Income Tax Act. At the same time it is necessary to consider the effect of the provisions of the Constitution upon the interpretation of DTAs, and to interpret the DTAs taking the national and international rules for the interpretation of statutes into account.

3. RESEARCH METHODOLOGY

The research was conducted by means of a critical analysis of documentary data and data from limited e-mail and telephonic interviews with the authors of textbooks and articles and academics, carried out in order to clarify contentious points. The documentary data included: the Income Tax Act, the Constitution, the Vienna Convention on the Law of Treaties and the findings by the local and international courts in relation to double taxation agreements, and writings by authoritative authors on the topic. The research methodology also included an analysis of relevant case law.

4. DOUBLE TAXATION AGREEMENTS

Rohatgi (2005:39) states that:

The primary purpose of double tax treaties is to avoid and relieve double taxation through equitable (and acceptable) distribution of tax claims between countries ...

Section 108(1) of the Income Tax Act empowers the National Executive to enter into double tax treaties 'with the government of any other country ..., with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation...'

Section 108(2) of the Income Tax Act states that '[a]s soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution... the arrangements so notified shall thereupon *have effect as if enacted in this Act*' (own emphasis).

As section 108(2) of the Income Tax Act specifically refers to section 231 of the Constitution, it is submitted that sections 108(1) and 108(2) should be read together with section 231(4) of the Constitution. Section 2 of the Constitution states that '[t]his Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid'. It is therefore important to recognise the role that the Constitution plays in interpretation of law in South Africa before referring to the South African legislation (and case law), which will influence the interpretation of DTAs in South Africa.

Section 231(4) of the Constitution, which makes provision for the conclusion of any international agreement, including DTAs, states that:

Any international agreement becomes law in the Republic... unless it is inconsistent with the Constitution or an Act of Parliament.

As the Income Tax Act is an Act of Parliament, it would appear from section 231(4) of the Constitution (if read in isolation), that the provisions of the Income Tax Act may take precedence over the provisions of an international agreement (for example a DTA), where the provisions of the international agreement and the provisions of the Income Tax Act are in conflict.

Both section 108(2) of the Income Tax Act and section 231(4) of the Constitution indicate, however, that a DTA shall have the same effect as if enacted as part of the Income Tax Act. Olivier and Honiball (2008) state further that international agreements do not in themselves enjoy a privileged status in South African law. The view that DTAs are to be regarded as if enacted as part of the Income Tax Act is supported by the judgement in *SIR v Downing*, which states that a DTA would 'have effect as if enacted in Act 58 of 1962 (see s108(2))', and by the judgment in *ITC 1544*, which states that:

the terms of a double taxation agreement on which statutory status has been conferred are to be considered as any other statutory provisions to determine the extent to which these conflict with the provisions of another statute and whether such provisions have been modified thereby...

As the provisions of DTAs will have the same legal standing and will rank equally with the other provisions of the Income Tax Act (section 108 of the Income Tax Act and section 231(4) of the Constitution), it is submitted that the normal rules of interpretation of statutes in South Africa will apply when interpreting the provisions of the DTA that conflict with the other provisions of the Income Tax Act. Olivier and Honiball (2008) are in agreement with this. Olivier and Honiball (2008) state further that international agreements generally do not in themselves enjoy a privileged status in South African law.

While there is international debate on the question whether the provisions of domestic law can override the provisions of tax treaties (Olivier & Honiball, 2008), this article will demonstrate that interpreting South African law as overriding tax treaties would be in conflict with the provisions of the Constitution.

The DTAs referred to above have a dual nature: on the one hand being classified as an international agreement and on the other forming part of domestic law (Olivier & Honiball, 2008). This view is supported by section 108(2) of the Income Tax Act, which states that the agreement referred to in that section is an agreement contemplated in section 231 of the Constitution, which deals with international agreements.

5. SOUTH AFRICAN RULES OF LEGISLATIVE INTERPRETATION

Steyn, MT set out the approach to be followed when interpreting fiscal statutes in his judgment in *ITC 1384* (1983):

Two principles of construction are of prime importance whenever a statute has to be interpreted, and they are that

- i) the main task is to ascertain the *intention of the legislator*, which is primarily to be sought in the language he chose to use ...
- ii) unless the contrary be clearly evident... the legislator is presumed not to have intended an unfair, unjust or unreasonable result. (own emphasis)

The importance of ascertaining the intention of the legislator is further supported by the judgment in *Dibowitz v CIR*, which states that 'in the interpretation of fiscal legislation the true intention of the legislature is of paramount importance, and, I should say, decisive.'

When interpreting the provisions of DTAs and the provisions of the Income Tax Act, the provisions should first be interpreted in such a way as to be consistent with each other (taking into account the intention of the legislator) (Olivier & Honiball, 2008).

Section 108(1) of the Income Tax Act seeks to prevent economic and juridical double taxation and states that '[t]he National Executive may enter into an agreement... with a view to the prevention, mitigation... of tax in respect of the same income... under the... laws of the Republic and of such other country'. While the objective of double tax treaties may be to prevent both juridical and economic double taxation, Olivier and Honiball (2008) make the point that tax treaties generally only eliminate juridical double taxation. Olivier and Honiball (2008:314) explain that economic double taxation refers to the 'imposition of comparable taxes by at least two tax jurisdictions on different taxpayers in respect of the same income' and that juridical double taxation refers to 'the imposition of comparable taxes by at least two tax jurisdictions on the same taxpayer in respect of the same income'.

As section 108 of the Income Tax Act provides for the conclusion of treaties to prevent the same income being taxed in both South Africa and another country, it would be illogical to interpret the section as meaning that it would not apply (eliminate double taxation) when the provisions of the Income Tax Act are in conflict with those of the DTA and impose a liability for tax, as such an interpretation would have the result that the provisions of section 108 (and that of the DTA) would be meaningless and serve no purpose. This view is supported by the Australian judgement in *Lamesa Holdings* (Olivier & Honiball, 2008). While foreign case law is not binding upon South African courts, it would have persuasive value if a similar principle were considered by the South African courts.

Section 108 of the Income Tax Act empowers the National Executive to enter into a DTA to prevent double taxation, and consequently it would be reasonable to assume that it was the intention of the legislature when enacting section 108 of the Income Tax Act, that where the provisions of the DTA would prevent double taxation and conflict with provisions of the Income Tax Act, the conflicting provisions should be interpreted in such a manner as to prevent double taxation (in a manner consistent with the objectives of section 108 of the Income Tax Act). This conclusion is supported by the judgment in *ITC 1544*, which states that:

[T]he law of South Africa includes section 108 of Act 58 of 1962 which itself makes the Income Tax Act subject to the Convention...

The effect of section 108(2) of the Act is to grant statutory relief in certain circumstances where the South African Act imposes a tax, where the provisions of a double-tax Convention grants an immunity or exemption from such tax to persons governed by the Convention. Tax is not payable to the extent to which an immunity or exemption from tax is granted in terms of a binding double tax Convention which has been proclaimed and thus has statutory effect. Secretary for Inland Revenue v Downing 1975(4) SA 518(A) at 523.

The judgements of the Income Tax Court are, however, not binding upon other South African courts and would therefore only have persuasive value.

As it is the intention of the legislature which should be sought when interpreting legislation, and as the intention of the legislature appears to be consistent with the stated objectives of section 108, it is submitted that where the provisions of the Income Tax Act and the DTA are in conflict, the DTA enacted in terms of section 108 of the Income Tax Act should be interpreted so as to prevent double taxation.

Such an interpretation would be consistent with the objective of both DTAs and the provisions of section 108 of the Income Tax Act, which is to prevent double taxation.

The view that section 108 of the Income Tax Act should be interpreted in such a way as to eliminate double taxation when there is a conflict between the provisions of the DTA and the other provisions of the Income Tax Act is further supported by the principle that a statute must be so interpreted as to be as unoppressive as possible. This principle finds support in the judgment of *Dibowitz v CIR*, which states that:

in the case of an ambiguity a fiscal provision should be construed *contra fiscum* . . . which is but a specific application of the general rule that all legislation imposing a burden upon the subject should, in the case of an ambiguity, be construed in favour of the subject.

De Koker (2009) makes the point that the *contra fiscum* principle must be applied when the provisions of the Income Tax Act reveal an ambiguity. That is, where the provisions of the Act are capable of two constructions, the court will interpret the legislation so as to impose the smaller burden upon the taxpayer. Therefore, when the provisions of the DTA, which are regarded as law in the Republic (in terms of section 231(4) of the Constitution), conflict with the provisions of the Income Tax Act, it is submitted that this results in an ambiguity, which in terms of the judgement in *Dibowitz v CIR* should be construed in favour of the taxpayer or *contra fiscum*.

The judgment of *Isaacs v CIR* held that 'the Income Tax Act should not be read as imposing tax upon a taxpayer twice in respect of the same profits unless the language of the statute makes it clear that such a result was intended . . .' It is submitted that this judgement is consistent with the argument that preference should be given to the DTA, which seeks to eliminate double taxation, and should be considered together with the *contra fiscum* principle when interpreting tax treaties.

Olivier and Honiball (2008) state that a DTA cannot increase the tax burden and may only have the effect of providing relief. As a DTA can never increase the tax burden, but always places a taxpayer in a better position, giving preference to the provisions of a DTA would be consistent with the decisions in *Isaacs v CIR* and *Dibowitz v CIR*.

The Income Tax Act and tax treaties should first be interpreted in such a way as to be consistent with each other, and it is only when this method of interpretation fails that one should consider which provision takes precedence and that this would be achieved by taking into account that:

- the intention of the legislator when enacting section 108 was to eliminate double taxation;

- the principle that legislation should be interpreted so as to be as unoppressive as possible;
- the principle that legislation should be interpreted *contra fiscum*; and
- the principle that the “Income Tax Act should not be read as imposing tax upon a taxpayer twice in respect of the same profits unless the language of the statute makes it clear that such a result was intended” (De Koker, 2009:25.3).

These guidelines merely summarise the principles discussed above.

6. PRINCIPLES APPLYING WHEN INTERPRETING DOUBLE TAXATION AGREEMENTS IN THE SOUTH AFRICAN CONTEXT

The judgement in *ITC 1544* makes it clear that the same principles should be applied when interpreting DTAs as any other South African legislation:

The terms of a Double Tax Convention on which statutory status has been conferred are to be considered as any other statutory provisions to determine the extent to which these conflict with the provisions of another statute and whether such provisions have been modified thereby.

Olivier and Honiball (2008) state that the Supreme Court of Appeal’s interpretation of a DTA in *SIR v Downing* raised no specific problems in interpreting the relevant provisions of the DTA in the context of South African domestic legislation. It also appeared from the judgment that the court would most probably embrace an international interpretation when interpreting DTAs.

During 2003 the Supreme Court of appeal decided in *AM Moola Group Ltd and Others v C: SARS* that:

if there were to be an apparent conflict between general provisions of the Customs and Excise Act and particular provisions of a trade agreement... the Act must, of course prevail in such case as the trade agreement, once promulgated, is by definition part of the Act...

Olivier (2009) stated that:

[t]he Moola judgement is currently the law in SA, but this does not mean that if the Supreme Court of Appeal is confronted with the issue again, it may not reach a different conclusion... it may decide to take section 233 [of the Constitution] into account and the decision will then be different.

Olivier, Brincker and Honiball (2004) provided insight into the international interpretation of DTAs when commenting on the judgement in *AM Moola Group Ltd and Others v CSARS*, and stated that any decision by the courts to interpret the provisions of the Income Tax Act as prevailing over the provisions of the DTA would be a departure from the international interpretation of DTAs.

As the judgment in this case related to trade agreements and not DTAs, it may be argued that the *ratio decidendi* would not be binding upon the court, if called upon to interpret the provisions of a DTA in the context of the provisions of the Income Tax Act in future, but would merely be of persuasive value. It is further submitted that the decision in *AM Moola Group Ltd and Others v CSARS* may be criticised on the basis that it did not take cognisance of section 233 of the Constitution, which requires a court to prefer ‘any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is

inconsistent with international law.' The implication of section 233 of the Constitution when interpreting South African legislation is discussed below.

The Supreme Court of Appeal considered the significance of DTAs in the 2012 judgement in *Commissioner for South African Revenue Service v Tradehold Ltd*, and concluded that '[a] double tax agreement ... modifies the domestic law and will apply in preference to the domestic law to the extent that there is a conflict'. While the judgement in this court case is in conflict with that in *AM Moola Group Ltd and Others v CSARS*, it is submitted that the legal principle set out in the judgement of *Commissioner for South African Revenue Service v Tradehold Ltd* is correct and supported by the argument put forward in this article. The judgement also emphasised that double taxation agreements should be interpreted in such a way as to give effect to the purpose of the DTA, which is to avoid double taxation.

7. THE INTERPRETATION OF DOUBLE TAXATION AGREEMENTS IN THE CONTEXT OF INTERNATIONAL LAW

Tax treaties form part of domestic legislation (section 108 of the Income Tax Act read together with section 231 of the Constitution), and section 233 of the Constitution requires the court to interpret any legislation (including tax treaties) in a manner consistent with international law.

The term 'international law' is defined by Olivier and Honiball (2008:32) as 'a legal system and principles which are binding upon states in their relationship with each other...', and includes 'the customary rules of international law, which are often referred to as the 'common law' of public international law...'

As the customary rules of international law form part of international law (Olivier & Honiball, 2008), it is submitted that section 233 of the Constitution would require the court to interpret the DTA in a manner which is consistent with the customary rules of international law (*inter alia*). It is further submitted that the South African courts are constitutionally bound to take customary international law into account, because section 232 of the Constitution states that customary international law is law in South Africa unless it is inconsistent with the Constitution or an Act of Parliament.

An additional motivation for interpreting a DTA in terms of customary international law is that a DTA is an international agreement, and consequently should be interpreted in terms of international law.

Rohatgi (2005:27) states that the Vienna Convention on the Law of Treaties applies 'to all international treaties, including tax treaties...' and 'essentially codifies the existing norms of customary international law on treaties'. Olivier and Honiball (2008) are in agreement with this statement.

As the Vienna Convention on the Law of Treaties is regarded as a codification of customary international law, section 232 of the Constitution provides that the Convention should be regarded as law in South Africa. The South African courts are therefore required by section 232 of the Constitution (read together with section 233 of the Constitution) to take the provisions of the Vienna Convention on the Law of Treaties into account when interpreting legislation (including tax and other treaties), unless the provisions of the Vienna Convention on the Law of Treaties are inconsistent with the Constitution or an Act of Parliament.

As the rules of the Vienna Convention on the Law of Treaties have been relied upon in court cases dealing with the interpretation of tax treaties in countries, that did not ratify the Vienna Convention on the Law of Treaties, the fact that South Africa did not ratify the Vienna Convention on the Law of Treaties does not affect the applicability of its articles in South Africa (Olivier & Honiball, 2008). The Vienna Convention on the Law of Treaties includes the following articles, which, it is submitted, are relevant when interpreting DTAs in relation to the other South African legislation, and which form part of South African law:

Article 26: *Pacta sunt servanda*

Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

Vogel (2004) argues that the effect of article 26 of the Vienna Convention on the Law of Treaties is that the tax treaties concluded by a country are binding upon it, and that a country should honour the terms of the DTA and not use domestic legislation to override the provisions of the DTA. Vogel adds that passing domestic legislation that overrides the provisions of a DTA is a breach of international law and does not in any way affect the continued existence of the country's international obligation.

The doctrine of legitimate expectation is also relevant when considering the requirement upon South Africa to respect and abide by the terms of tax treaties, which it has concluded. The doctrine of legitimate expectation has been defined in *Administrator, Transvaal and Others v Traub and Others* as 'the duty to act fairly', and is consistent with the requirement to act in 'good faith'.

Article 31: General rule of interpretation

A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

Olivier and Honiball (2008) confirm that the principles of the Vienna Convention on the Law of Treaties should be taken into account when interpreting a DTA, and that the agreement should be interpreted in good faith and in the light of its objects, which are to 'avoid the same income being taxed twice'.

Interpreting an agreement in good faith includes honouring the agreement, which was concluded with another country, and not using domestic legislation to override the provisions of the DTA. It is also clear that if the provisions of the DTA conflict with domestic legislation, the courts should prefer the interpretation of the DTA, which would be consistent with its object and purpose, which is to eliminate double taxation.

8. CONCLUSION

This article has discussed the legal status of tax treaties in relation to the provisions of the Income Tax Act, taking into account the Constitution and the national and international rules for the interpretation of statutes. From the discussion presented, the following conclusions have been reached:

- a) As tax treaties have a dual nature – forming part of domestic legislation and being classified as international agreements – the tax treaties will have the same legal

effect as any other section in the Income Tax Act, and should therefore be interpreted in accordance with the South African rules regarding the interpretation of statutes.

- b) When there is a conflict between the provisions of the DTA and the provisions of the Income Tax Act, it is concluded that the provisions of the tax treaties should be taken as overriding the conflicting legislation in the Income Tax Act. This conclusion is supported by the following:
 - i) The intention of the legislator must be taken into account when interpreting legislation. As the DTA was entered into in order to prevent taxation being levied twice in respect of the same income, and it is the objective of both section 108 and the DTA that double taxation be prevented, it is concluded that the legislation would be meaningless if the provisions of the Income Tax Act override the provisions of the DTA.
 - ii) In the event of ambiguity a fiscal provision should be construed *contra fiscum* (that is in favour of the subject). It is therefore submitted that if the provisions of the Income Tax Act and the provisions of the DTA are in conflict, the court would interpret the conflicting legislation in such a manner as to impose the least burden upon the taxpayer. This is consistent with the objective of the DTA, which is to prevent, mitigate or discontinue double taxation.
 - iii) 'The Income Tax Act should not be read as imposing tax upon a taxpayer twice in respect of the same profits unless the language of statute makes it clear that such a result was intended' (De Koker, 2009:25.3). It is submitted that this too is consistent with the intention of entering into a DTA, which is to prevent, mitigate or discontinue double taxation.
 - iv) The judgment in *Commissioner for South African Revenue Services v Tradehold Ltd*, which states that the provisions of a DTA modify domestic law and 'will apply in preference to domestic law'.
- c) As section 232 of the Constitution provides that customary international law forms part of the law in South Africa (unless it is inconsistent with the Constitution or an Act of Parliament), it is concluded that the Vienna Convention on the Law of Treaties, which is a codification of customary international law, would form part of South African law and the principles detailed in the Vienna Convention on the Law of Treaties should be taken into account when interpreting South African legislation (including tax treaties).
- d) The South African courts would be required to take the provisions of the Vienna Convention on the Law of Treaties into account when interpreting South African legislation, as section 233 of the Constitution requires the courts to interpret legislation (including tax treaties) in a manner consistent with international law (of which customary international law forms a part).
- e) The following principles of the Vienna Convention on the Law of Treaties should be taken into account when interpreting treaties in South Africa (including tax treaties):
 - i) The treaty is binding upon the parties to the treaty.

- ii) The treaty should be interpreted in the light of its objects and purpose, which is similar to the South African requirement that the intention of the legislature should be looked to when interpreting legislation.
- iii) The treaty should be interpreted in good faith – that is, interpreted in accordance with its stated objects and purpose (to prevent double taxation).
- iv) A country should not invoke domestic legislation as a justification for failing to perform a treaty.

As the courts of South Africa are required by the Constitution to take the provisions of the Vienna Convention on the Law of Treaties, which is regarded as a codification of international law, into account when interpreting DTAs, it is submitted that when the provisions of a DTA conflict with provisions in the Income Tax Act, the DTA should be interpreted so as to give effect to its objects and purposes, which is the elimination of double taxation.

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