

22 June 2018

The National Treasury

240 Madiba Street

PRETORIA

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The South African Revenue Service

Lehae La SARS, 299 Bronkhorst Street

PRETORIA

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RE: CONSEQUENTIAL AMENDMENT TO DEFINITION OF PERMANENT ESTABLISHMENT

The South African domestic definition of “permanent establishment” (in section 1 of the Income Tax Act) is defined with reference to the definition of permanent establishment in Article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development (MTC). Our domestic definition is, therefore, consequentially amended every time that the MTC definition is amended.

The Organisation for Economic Co-operation and Development (OECD) updated the MTC in November 2017 to include its Base Erosion and Profit Shifting (BEPS) permanent establishment (PE) recommendations. Article 5(5) was amended to widen the 'conclusion of contracts' agency PE rules. Essentially a person can now create a PE, even if the person does not have the authority to conclude contracts, but if the person habitually plays the principal role leading to the conclusion of contracts.

South Africa made an election not to update Article 5(5) of its Double Tax Agreements (DTA's) in its MLI submission to the OECD. Therefore, for DTA purposes, the narrower definition will continue to apply. However, because the South African domestic definition of PE (in section 1 of the Income Tax Act) refers to the MTC definition, the domestic definition was widened when the MTC was updated.

A few examples of the potential impact of this incongruity includes:

- The taxing threshold for a foreigner selling goods in South Africa is a PE. Why should our domestic law have a stricter test than what we apply under DTAs, and which would in any event be overridden by them?
- And it works the other way. A royalty or interest will not have a South African source if it's attributable to a foreign PE. Now it's easier to attribute to a foreign PE than before.

We query whether it was intended that the domestic definition should be widened after a policy decision was taken not to update the DTA definition, or alternatively whether a legislative amendment can be made to the domestic definition of PE to address this unintended consequence.

We appreciate and welcome our ongoing engagement.

Yours sincerely

Erika de Villiers

Head of Tax Policy