

SOUTH AFRICA / JUDGMENT

## X v Commissioner For The South African Revenue Service (14218) [2018] ZATC 9; 80 SATC 472 (9 March 2018) [2018] ZATC 9

COURT  
Tax Court

BEFORE  
Allie

CASE / FILE NUMBER  
14218

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IN THE TAX COURT OF SOUTH AFRICA  
(WESTERN CAPE DIVISION, CAPE TOWN)

CASE NO: 14218

In the matter between:

Mr X

Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN

Respondent

REVENUE SERVICE

JUDGMENT: 9 MARCH 2018

ALLIE, J:

1. Appellant appeals against the Commissioner's disallowance of R4 069

765,00 claimed by appellant as non-taxable foreign income earned during the 2014 financial year, for services that he rendered to his employer outside South Africa.

2. It is common cause that for 62 non-continuous days, appellant worked outside South Africa.

3. Initially there was some dispute concerning the identity of the employer but at the hearing it was accepted by both sides that appellant was employed by ABC Incorporated, South African Branch, which is a branch of ABC Incorporated, United States, the branch having been registered in South Africa as an external company.
4. On 31 March 2011 the appellant entered into a contract of employment in Johannesburg with his employer. The material terms are: that he was employed by the Johannesburg Branch of the company; that he would be remunerated an annual salary net of taxes which would be paid to him in equal monthly instalments; and appellant was not allowed to engage in extraneous part-time employment without permission.
5. It is common cause that the appellant's total income from his employment during the period 1 March 2013 to 31 October 2013 was an amount of R10 437 708,00 and that he declared the amount of R6 367 943,00 as income earned from services rendered inside South Africa.
6. Appellant's employer issued an IRP5 certificate reflecting the annual income for the 2014 year of assessment as R10 437 708,00 against which it paid PAYE.
7. Appellant contends that the certificate incorrectly included an amount of R4 069 765,00 as taxable gross income. That amount was arrived at by dividing the number of days that appellant worked outside the country by the total number of working days in the relevant tax period and thereafter by multiplying the result by the total income earned for that period.
8. At the inception, the issue of whether the appellant was ordinarily resident in South Africa during the relevant tax period or whether he fell into the exclusionary provision of the definition of resident in section 1(b) of the Income Tax Act 52 of 1962 ("ITA"), namely whether he is deemed to be an exclusive resident of another country was in dispute. During argument, counsel for the respondent, correctly abandoned the residency point.
9. The remaining question for determination is whether the disputed income can be categorised as having been received by the appellant from "a source within the Republic" as contemplated by section 1(ii) in the definition of "gross income" of the ITA.
10. Gross income is defined in the ITA as follows:

*"(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...."*
11. Article 15(1) of the Double Taxation Agreement ("DTA") between South Africa and the United States provides for taxation in South Africa of remuneration derived by a resident of the U.S. where the employment is exercised in South Africa.

12. Respondent's counsel developed the argument on source and where the employment was exercised as follows:

12.1. For the 62 days that appellant worked outside S.A., he did so at the request of his employer;

12.2. He was remunerated by his employer in S.A. for those 62 days in a manner where his employer made no distinction between the days

he worked in S.A. and the days he worked outside S.A.;

12.3. Appellant's accountant, Mr Y testified that he obtained an average daily salary by his own calculation and multiplied that

average by 62 days without having established what his actual remuneration was for the 62 days;

12.4. Appellant's income fluctuated drastically from month to month to such an extent that distilling an average daily salary is

artificial and not based on the actual remuneration paid for the 62 days;

12.5. The originating cause of appellant's disputed income is the contract of employment which was entered into in South Africa and

exercised in South Africa for all the days that he worked in S.A.;

12.6. He actually performed his consequential contractual obligations to his employer outside S.A. for 62 days. He did not perform his obligations to the individual recipients of his services in other countries;

12.7. The nature of the services he rendered outside S.A. were set out in a letter from a company purporting to be appellant's employer and there is no suggestion in the letter that appellant acted beyond the scope of his employment;

12.8. Respondent's counsel submitted that the source of the remuneration is the employment and not the services rendered by appellant to individual clients of the employer outside of S.A.;

12.9. Respondent relied on the authority of *First National Bank of SA (Pty) Ltd v CLR*,<sup>[1]</sup> where the Court found that the legislature had not attempted to define the phrase "source within the Republic", but clearly left it to the Courts "...to decide on the particular facts of each case whether an amount was or was not

received from such a source". In so doing, the court relied on the decision in *Essential Sterolin Products (Pty) Ltd v Commissioner for Inland Revenue*<sup>[2]</sup> where the court cited with approval the decisions in *CSIR v Lever Bros and Another*,<sup>[3]</sup> *CSIR v Epstein*<sup>[4]</sup> and *CSIR v Black*.<sup>[5]</sup> The Court cited with approval the need to consider the "factual matrix" and the idea that the "...ascertainment of the actual source of a given income is a practical, hard matter of facts";<sup>[6]</sup>

12.10. Respondent's counsel advanced the argument that a company registered in S.A. albeit registered as an external company which is a branch of a company registered outside S.A., has its own independent assets and liabilities and exists as a fully-fledged legal entity in S.A. He relied on the case of *John Stanley Ward & Gurr & Others v Zambia Airways Corporation Ltd*[7] as authority for that proposition.

13. The entire dispute hinges on the definition of where the employment is exercised and consequently where the source of the remuneration is located, as set out in the DTA, which became a part of our law upon notification that it had entered into force.

14. On appellant's behalf it was submitted that the South African branch of ABC

Incorporated was not a separate juristic entity and accordingly it could not have been the entity where the originating cause of the remuneration was located.

15. Appellant's counsel submitted that the originating cause of the appellant's remuneration was the services rendered by him to his employer, and that such originating cause was located at the places where the services were rendered.

16. In *CSARS v Van Kets*,[8] with reference to the applicability and interpretation of a DTA, the court said:

*"[25] It would thus appear as if the DTA provisions become part of domestic income laws. Given the manner in which the DTA stands to be treated in terms of s 231 of the Constitution, its provisions must rank at least equally with domestic law, including the Act. For this reason, the provisions of the DTA and the Act, should, if at all possible, be reconciled and read as one coherent whole."*

17. Article 15 (1) of the DTA reads as follows:

*"Dependent Personal Services*

(1) Subject to the provisions of Articles 16 (Directors' Fees), 18 (Pensions and Annuities) and 19 (Government Service), salaries, wages and other remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised such remuneration as is derived may be taxed in that other State."

(my emphasis)

18. In *SIR v Downing*[9] the court said that the DTA "makes liberal use of what has been termed international tax language".

19. Interpretation of the provisions of the DTA, which is a Convention, may be in accordance with the Vienna Convention on the Law of Treaties ("VCLT") of 1969, which provides a general guide on how a treaty/convention

ought to be interpreted under the VCLT, in Articles 31 to 33. Further guidance is given in the Commentary on the preliminary draft of the VCLT, under Article 32.

20. South Africa has not signed the VCLT. The VCLT incorporates international customary law.

21. Section 232 of the Constitution of the Republic of South Africa, 1996, provides as follows:

*“Customary International Law*

Customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament.”

22. The VCLT subscribes to customary international law, applicable to all countries including South Africa.[10] In my view, a portion of it may find application in South Africa.

23. Article 31 of the VCLT contains the general rule of interpretation. Article 31(1) states:

*“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.”*

24. The VCLT contains the following primary rules:

24.1 The interpretation should start primarily with the ordinary meaning of the words in the text, as expressed and not as intended, with due regard being had to the context in which they occur.

24.2 Where there is ambiguity, the ordinary meaning that defines the terms in accordance with the object of the treaty should prevail.

24.3 The ordinary meaning of words in the agreement may be, but is not necessarily, the everyday meaning. It is the uniform legal usage,

e.g. international tax language or the specific legal usage employed by the Contracting States.

24.4 A tax convention must be interpreted as a whole and in a manner that does not conflict with the whole agreement.

24.5 The words must be given the meaning they actually held at the time when the Convention was concluded and not what the parties subsequently believe it to be. The Technical Explanation of the relevant Convention, to which I was referred by appellant’s counsel is accordingly no more than a guide and cannot expand upon the words used in the Convention nor can their words be substituted for those in the Convention.

24.6 Identical terms in a Convention should be given the same meaning.

25. The primary rules of interpretation suggested by the VCLT is not at odds with the primary rules of interpretation used in our domestic law, namely the plain meaning of the text in conjunction with a purposive and contextual approach.

26. In view of my finding that there is no conflict between the statutory interpretation proposed by the VCLT and those applicable in South Africa, I will apply the latter.
27. The place where: "... the employment is exercised..." ordinarily means the place where the employment agreement is implemented. The words are used for the purpose of describing events that occur in fulfilment of reciprocal rights and duties governed by an employment agreement, as they appear in the context of Article 15, in the DTA.
28. The words are meant to serve as an exception to the rule that the country in which a person is a resident shall levy tax on income of that resident derived from salaries, wages or other remuneration. The exception is that a country in which that person is not a resident but in which his/her employment is exercised, provided that the income is derived from that employment, is the country which may levy tax on that income.
29. If the words were meant to convey the meaning that the non-resident country must be the country in which the person fulfils his/her employment obligations at any given time, then the active voice would have been used in the construction of the relevant phrase. Instead, the phrase is constructed in the passive voice with the employment as the subject and no actor is mentioned.
30. It is left to the laws of the individual contracting states to determine when and how employment is considered to be exercised. The last sentence in sub- article 1 of Article 15 reinforces this understanding because it uses the same phrase, namely. "If the employment is so exercised..." So too does sub-article 2 of Article
15. It uses the words "employment exercised..." No mention is made of where each actor must be located when the employment is exercised.
31. The contract of employment was entered by appellant in South Africa. He chose a South African address as his domicilium, as did his employer. In the absence of an express provision to the contrary in the contract, the laws of South Africa clearly governed the contract.[11]
32. Appellant and his employer were content to declare his income for services he rendered inside S.A. to SARS for the purpose of paying income tax.
33. Section 23 of the Companies Act 71 of 2008, which came into operation on 1 May 2011, deals with the situation where a foreign company is required to register as an external company with the Companies and Intellectual Property Commission (CIPC).
34. The term "external company" is defined in the Act as an entity incorporated

outside of South Africa that is carrying on business or non-profit activities in South Africa, subject to section 23(2). Although the Companies Act does not make use of the term “branch”, an external company is often referred to as such. The effect of the registration of a foreign company as an external company in South Africa is that the foreign company is given legal recognition in South Africa, for taxation purposes, at least.

35. Section 23(2) stipulates that a foreign company must be regarded as “conducting business” or “non-profit activities” within South Africa if it –

*“(a) is a party to one or more employment contracts within the Republic; or*

- (b) subject to subsection 2A, is engaging in a course of conduct, or has engaged in a course or pattern of activities within the Republic over a period of at least six months, such as would lead a person to reasonably conclude that the company intended to continually engage in business ... within the Republic.”

36. Section 23(2A) provides that, when applying s 23(2)(b), a foreign company must not be regarded as “conducting business activities within” South Africa solely on the ground that the foreign company is or has engaged in one or more of the following activities:

*“(a) holding a meeting or meetings within the Republic of the shareholders or board of the foreign company, or otherwise conducting any of the company’s internal affairs within the Republic;*

- (b) establishing or maintaining any bank or other financial accounts within the Republic;
- (c) establishing or maintaining offices or agencies within the Republic for the transfer, exchange, or registration of the foreign company’s own securities;
- (d) creating or acquiring any debts within the Republic, or any mortgages or security interests in any property within the Republic;
- (e) securing or collecting any debt, or enforcing any mortgage or security interest within the Republic; or
- (f) acquiring any interest in any property within the Republic.”

37. An analagous situation exists in this case, where appellant held meetings outside South Africa during those 62 days.

38. In determining where the employment is exercised, it is useful to answer the following questions:

38.1 What the contract itself stipulates concerning the law governing it;

38.2 Where the contract was concluded;

38.3 Who is paying the employee;

38.4 Who the services are being rendered to;

38.5 Where the services are being rendered;

39. The answer to the first 2 questions has to be South Africa. The answer to the third is the employer in S.A. and the fourth answer is to the employer. The answer to the last question is outside S.A. to the client of the employer and inside S.A. to the employer for the relevant 62 days.
40. The contract is of such a nature that one must assume that the resources, knowledge, skill and expertise that the appellant had at his disposal to utilise in his rendering of services, all became those of his employer for the duration of the employment contract. I come to that conclusion in the absence of evidence to the contrary and on the understanding that the appellant was not an independent contractor.
41. The appellant rendered the services outside S.A. not as an independent contractor, but as a representative of the employer. He accordingly rendered those services to the employer's clients qua the employer. In effect and in substance, appellant therefore rendered the services to his employer.
42. The nature of those services, according to the employer's letter to the SARS, encompassed, inter alia, training directors and holding business meetings. Appellant failed to lead evidence concerning the particulars of the services rendered nor was evidence adduced concerning why the services ought to be considered as having been rendered to the employer's clients as opposed to it having been rendered to the employer in fulfilment of appellant's employment obligations.
43. Appellant bears the onus of proving his case in terms of section 102(1) of the Tax Administration Act 28 of 2011.
44. In *Lever Bros*'[12] case the court looked at the originating cause of the remuneration, which in casu is the contract of employment, to determine the source.
45. In *Lever Bros* the court held as follows:

*"When the question has to be decided whether or not money, received by a taxpayer, is gross income within the meaning of the definition referred to above, two problems arise which have not always been differentiated from one another in decided cases. The first problem is to determine what is the source from which it has been received and when that has been determined, the second problem is to locate it in order to decide whether it is or is not within the Union."*

The word 'source' has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money, one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our income tax acts and upon similar acts elsewhere have dealt with the meaning of the word 'source', and the inference, I think, which should be drawn from those decisions is that the source of receipts,

received as income, is not the quarter whence they come, but the originating cause of their being received as income, and that this originating cause is the work which the taxpayer does to earn them, the quid pro quo which he gives in return for which he receives them. The work which he does may be a business

which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal

exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these.”

46. Section 9(2)(h) of the ITA states that:

*“An amount received by or accrues to a person from a source within the Republic if that amount—*

- (h) is received or accrues in respect of services rendered or work or labour performed for or on behalf of any employer—
- (i) in the national, provincial or local sphere of government of the Republic;
- (ii) that is a constitutional institution listed in Schedule 1 to the Public Finance Management Act;
- (iii) that is a public entity listed in Schedule 2 or 3 to that Act; or
- (iv) that is a municipal entity as defined in section 1 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).”

(my emphasis)

47. The sub-section emphasises a determinative factor as being the performance of work or rendering of services by an employee for or on behalf of an employer.

48. I am persuaded that there is a sufficiently close connection between the *raison d'être* for rendering the service outside S.A. and the employment contract to interpret the rendering of the services as no more than reciprocal performance by the appellant to his employer. In reciprocal contracts, unless stated to the contrary, there are no grounds for elevating one party's performance as being determinative of implementation of the contract. Both sides are duty-bound to render their respective performance. The interpretation of “employment exercised” as only occurring upon the rendering of services by the employee ignores the reciprocal performance required of the employer, which is to provide the employee with the necessary resources to enable him to render his performance; to specify particular services that the employee is bound to render and to remunerate the employee.

49. The source of the remuneration received by the appellant during the 62 days that he rendered services for his employer outside S.A. is the same source from which remuneration was derived in the remaining days that he rendered services for his employer inside S.A.

50. Concerning costs, I am in agreement with the submission made on appellant's behalf that the respondent's ground of assessment were unreasonable in the following respects:

50.1 the respondent himself pleaded that the appellant was a United States national and tax resident, yet it failed to have regard to the provisions of the DTA which clearly establish the appellant as being exclusively resident in the United States;

50.2 the respondent himself recognised that the appellant was not "ordinarily resident" in South Africa, for if this were

not the case it would not have been necessary to rely on the number of days the appellant spent in South Africa to establish his alleged residence here;

50.3 the respondent relied on section 10(1)(o)(ii) of the Act despite the fact that the appellant had never relied on this exemption in his tax return, nor had he done so in his original Rule 32 statement of the grounds of appeal, which expressly stated that section 10(1)(o)(ii) was not relied on and was irrelevant;

50.4 the respondent has not pleaded that the appellant was "ordinarily resident" in South Africa, the implication of which is that it was obvious that the appellant was not a resident of South Africa in terms of the DTA but was a resident of the United

States in terms of the DTA, the effect of which was to exclude him from the definition of "resident" in section 1 of the Act, yet the respondent pleaded in its amended Rule 31 statement of the grounds of assessment that the appellant was a "resident"

as defined in the Act.

51. In view of the dearth of legal authority on the interpretation of the relevant words in the DTA, the appellant's grounds of appeal cannot be said to be unreasonable.

52. The respondent ought to bear the appellant's costs of opposing the grounds of assessment relating to residence.

IT IS ORDERED THAT:

1. The Additional Assessment is upheld on the grounds only that the source of the disputed income was from within the Republic of S.A. and the employment was exercised, in substance, in the Republic of South Africa;
2. Respondent is ordered to pay appellant's costs incurred in opposing the ground of assessment relating to residence.

R. ALLIE

[1] 2002(3) SA 375 (SCA) at [12].

[2] 1993(4) SA 859 (A) AT 870C to 871B.

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- [3] 1946 AD 441.
- [4] 1954(3)SA 689 (A).
- [5] 1957 (3) SA 536 (A).
- [6] Nathan v Commissioner of Taxation [1918] HCA 45; (1918) 25 CLR 183 at 189 -190.
- [7] 1998(2) SA 175 (SCA).
- [8] 2012(3) SA 399 ( WCC) at [25].
- [9] 1975(4) SA 518 (A) at 523 C-D.
- [10] The incorporation of double taxation agreements into South African domestic law: Potchefstroom Electronic Law Journal 2015(18) 4: I. Du Plessis.
- [11] Ex Parte Spinazze & Another NNO 1985  
(3) SA 650 AD at 665 G – H.
- [12] Supra at 449 – 450.
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